Swedish Fiscal Policy

Fiscal Policy Council Report 2015

The Swedish Fiscal Policy Council is a government agency. Its remit is to conduct an independent evaluation of the Government's fiscal policy. The Council fulfils its tasks primarily through the publication of the report Swedish Fiscal Policy, which is presented to the Government once a year. The report is used by the Riksdag as a basis for its evaluation of the Government's policy. The Council also arranges conferences. In the series Studier i finanspolitik (Studies in fiscal policy), it publishes in-depth studies of different aspects of fiscal policy.

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Foreword

The Fiscal Policy Council is to "review and assess the extent to which the fiscal and economic policy objectives proposed by the Government and decided by the Riksdag are being achieved, in order thus to contribute to more transparency and clarity about the aims and effectiveness of economic policy". The Council will also promote more public debate in society about economic policy.

The Council consists of six members. Since the previous report in May 2014, Steinar Holden and Eva Lindström have left the Council. Hilde C. Bjørnland and Yvonne Gustafsson are new members.

The Council is assisted by a secretariat consisting of Joakim Sonnegård (Head of Agency), Niklas Frank (Deputy Head of Agency and Senior Economist), Karolina Holmberg (Senior Economist), Johanna Modigsson (Economist) and Charlotte Sandberg Gavatin (Head of Administration). This is the Council's eighth report. In the work on this year's report, nine working meetings have been held. The analytical work was completed on 30 April. The Council has commissioned three background papers. They will be published in the Council's publication series, *Studier i finanspolitik* (Studies in fiscal policy):

1. Maria Börjesson and Jonas Eliasson – Om investeringar och transportinfrastruktur.
2. Giancarlo Corsetti and Gernot Müller – Fiscal multipliers: Lessons from the great recession for small open economies.
3. NIER – Fördelningseffekterna av sex förslag ur budgetpropositionen för 2015.

We have received many valuable comments. We would particularly like to thank everyone who has presented reports at Council working meetings: Giancarlo Corsetti, Jonas Eliasson, Robert Ford, Jesper Hansson, Erik Höglin, Erik Jonasson, Gernot Müller, Elin Ryner and David Sundén.

Our dialogue with colleagues at the National Institute of Economic Research is valuable in our work. Over the past year, the special cooperation with Erik Höglin, Karine Raoufinia and Elin Ryner has been important. Aila Ahsin, Åsa Holmquist and Tommy Persson have given the Council excellent administrative support.

Finally, we would also like to thank Åsa-Pia Järliden Bergström, Karin Edmark, Thomas Eisensee, Jonas Eriksson, Lars Ernsäter, Erik Hegelund, Thomas Helgeson, Håkan Jönsson, Albin Kainelainen, Petter Lundberg, Anna-Kirsti Löfgren, Monika Hjeds Löfmark, Markus Jäntti, Hans Sacklén, Ole Settergren, Daniel Suhonen, Daniel Waldenström and Ann-Sofie Öberg for their interesting views and constructive comments.

Stockholm, 30 April 2015

John Hassler
Chairman

Irma Rosenberg
Deputy Chairman

Anders Björklund

Hilde C. Bjørnland

Yvonne Gustafsson

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Abbreviations

AF	Arbetsförmedlingen (Swedish Public Employment Service)
LFS	Labour Force Surveys
BP	Budget Bill
GDP	Gross Domestic Product
CSN	Centrala studiestödsnämnden (National Board of Student Aid)
ECB	European Central Bank
ESA	European System of Accounts
ESV	Ekonomistyrningsverket (Swedish National Financial Management Authority)
EU	European Union
EU-SILC	EU statistics on income and living conditions
FASIT	Distribution analysis system for incomes and transfers
HEK	Household Finances (Statistics Sweden)
IFAU	Institutet för arbetsmarknads- och utbildningspolitisk utvärdering (Institute for Evaluation of Labour Market and Education Policy)
IMF	International Monetary Fund
ISF	Inspektionen för socialförsäkringen (Swedish Social Insurance Inspectorate)
NIER	National Institute of Economic Research
KU	Konstitutionsutskottet (Committee on the Constitution)
LAS	Lagen om anställningsskydd (Employment Protection Act)
LINDA	Longitudinal Individual Data Base (Statistics Sweden)
MTO	Medium Term Objective
NEET	Not in education, employment or training
NPVR	Net present value ratio
NA	National Accounts
OECD	Organisation for Economic Co-operation and Development
PM	Pensionsmyndigheten (Swedish Pensions Agency)
RA	Riksdag Act
SCB	Statistiska centralbyrån (Statistics Sweden)
SFS	Svensk författningssamling (Swedish Code of Statutes)
SOU	Statens offentliga utredningar (Swedish Government Official Reports)
TFP	Total Factor Productivity
Ea	Expenditure area
VP	Spring Fiscal Policy Bill
VÄB	Spring Amending Budget
ÅP	Old-age pension system

Contents

The Fiscal Policy Council's remit

The Fiscal Policy Council, in accordance with its instruction, is to review and evaluate the extent to which the fiscal and economic policy objectives proposed by the Government and decided by the Riksdag are being achieved and thus contribute to more transparency and clarity about the aims and effectiveness of economic policy.[1]

In particular, the Council, with the Spring Fiscal Policy Bill and the Budget Bill as its basis, is to assess whether fiscal policy is consistent with:

1. long-term sustainable public finances, and
2. budgetary targets, particularly the surplus target and the expenditure ceiling.

The Council, with the Spring Fiscal Policy Bill and the Budget Bill as its basis, is also to:

1. assess whether the fiscal stance is consistent with cyclical developments in the economy,
2. assess whether fiscal policy is in line with healthy long-term sustainable growth and leads to long-term sustainable high employment,
3. examine the clarity of these bills, particularly with respect to the specified basis of economic policy and the reasons for proposed measures, and
4. analyse the effects of fiscal policy on the distribution of welfare in the short and the long term.

The Council may review and assess the quality of the forecasts presented and the models on which the forecasts are based.

The Council is also to work to stimulate more public debate of economic policy.

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[1] SFS 2011:446.

The fiscal framework

The fiscal framework consists of the fundamental principles that fiscal policy is to follow to be sustainable in the long term.[2] Some of these principles are governed by law, while others follow practice.

The budgetary framework is a core component of the fiscal framework. The budgetary framework includes a surplus target for general government net lending, an expenditure ceiling for central government expenditure, excluding interest expenditure, and for old age pension system expenditure, and a balanced budget requirement for local governments.

Under the Budget Act, the Government is obliged to present a proposed target for general government net lending. The Riksdag has established the surplus target as follows: net lending should amount to, on average, 1 per cent of GDP over an economic cycle.

Under the Budget Act, the Government must propose an expenditure ceiling for the third year ahead in the Budget Bill. The Riksdag sets the expenditure ceiling. Under the expenditure ceiling, there is customarily a budgeting margin of a specified size. This will primarily act as a buffer if expenditures develop in an unexpected way because of cyclical developments.

The expenditure ceiling is the overarching restriction in the budget process. In the budget process, priorities are set for different expenditures and expenditure increases are considered in the light of a predetermined total fiscal space provided by the expenditure ceiling and the surplus target. The main thrust is that proposals for expenditure increases in an expenditure area have to be covered by proposals for expenditure reductions in the same area.

Since 2000 there has been a balanced budget requirement in effect in the local government sector. The balanced budget requirement states that each municipality and county council must plan for a balanced budget, if there are no exceptional reasons.

The Government has drawn up a number of principles to guide stabilisation policy. Fiscal policy's most important contribution to stabilising the economy is to maintain confidence in the long-term sustainability of the public finances. In the event of normal demand

[2] This summary is based on the Ministry of Finance (2011b).

shocks, monetary policy will stabilise both inflation and demand in the economy. The Government then sees no reason to take any active, i.e. discretionary, fiscal policy measures. Given shocks of this kind, fiscal policy will have a countercyclical effect via the automatic stabilisers.

In the event of very large demand and supply shocks, an active fiscal policy may be needed. The fiscal measures in this case will help limit the rise in unemployment, reduce the risk of unemployment becoming entrenched and mitigate the consequences for particularly vulnerable groups.

The stabilisation policy measures should also be designed in such a way that they do not prevent net lending from returning to a level compatible with the surplus target when capacity utilisation is once again normal.

It is the Government's view that in financial crises, it has to take special measures to contribute to financial stability. The Government presumes that the fiscal consequences of such measures should be limited. Any losses arising in the financial sector must initially be borne by credit institutions themselves, their shareholders and others who have contributed risk capital.

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.

1 The economic situation

Chapter 1 provides a clear picture of the economic situation. The Council discusses and evaluates the Government's economic policy in the light of this in forthcoming chapters. The chapter is based on material published by other analysts and forecasters. When the Council makes its own estimate, it is indicated in the text. This chapter also discusses productivity development after the crisis and paints a picture of how income distribution has developed.

In section 1.1, there is an international overview. Section 1.2 describes economic developments in Sweden. Section 1.3 discusses the effects the crisis has had on long-term growth in Sweden, and section 1.4 provides an overview of how income distribution has developed. Section 1.5 summarises the Council's assessments and recommendations.

1.1 The international economic situation[1]

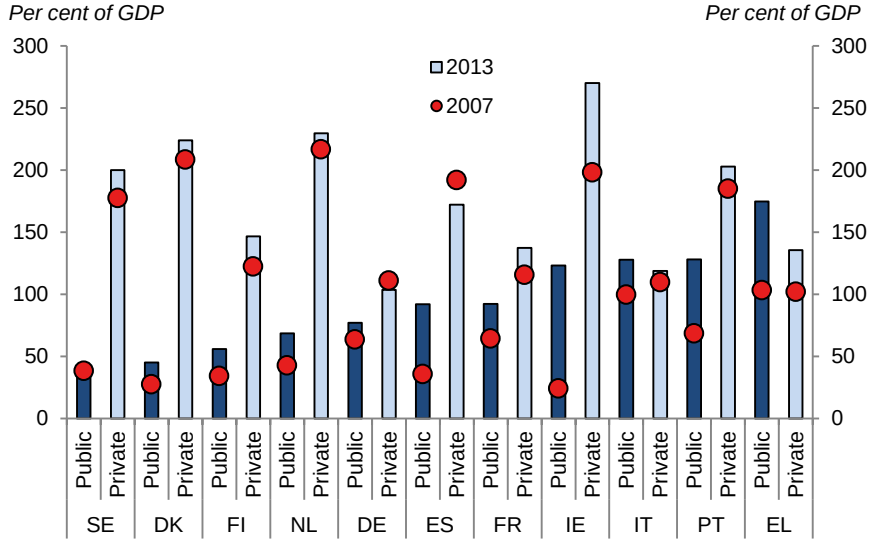
The global economic situation is improving. Capacity utilisation is initially low on account of the financial crisis and Euro crisis, which means it will take a long time for the global economic situation to normalise. The prospects for the USA and United Kingdom are relatively bright. The same is true of emerging economies such as Indonesia and South Africa. In Japan, China, Brazil and Russia, on the other hand, the economic activity level is expected to remain low compared with what has been normal for these economies. Unemployment is very high in the Eurozone, and capacity utilisation is low. However, there are signs that a recovery may be taking place. Measures implemented by the European Central Bank (ECB), with greatly reduced interest rates and quantitative easing, have been important, as has the falling price of oil. The European Commission has eased its pressure on member states to consolidate public finances. All of this will facilitate a recovery.

Since the crisis, austerity policies pursued in Europe have led to a consolidation of public finances in terms of higher government net lending in the majority of EU member countries. At the same time,

[1] This section is based on EEAG (2015), IMF (2015a), IMF (2015b), NIER (2015c), OECD (2014a) and OECD (2015d).

government debt in the majority of EU countries is currently at a higher level than before the crisis. Debt in the private sector has also increased during the crisis years and now stands at historically high levels in a number of countries (Figure 1.1). Therefore, households are expected to attempt to reduce their debt over the next few years, which will rein back private consumption and hold back growth.

Figure 1.1 Debt in the public and private sector, 2007 and 2013



Note: Government debt refers to the consolidated gross general government debt, known as the Maastricht debt. Private debt refers to consolidated debt for households, households' non-profit organisations and non-financial companies.
Source: Eurostat (2015). For a list of the country codes, see Eurostat (2012).

However, risks of weaker international economic development continue to dominate. The low interest rates have driven up asset prices, and any new turmoil in central government finances in the Eurozone could cause an abrupt price drop. The limited scope in central government finances for fending off the consequences of a sudden drop in asset prices will make it difficult to maintain demand in such a situation. Geopolitical uncertainty also remains high. Despite these risks, the prospects for good economic development are better than we have seen in several years.

Box 1.1 The drop in the price of oil and the Swedish economy

Oil prices have fallen by 40–50 per cent over the past six months, and this has impacted upon manufacturers, export companies, governments and consumers. Although countries are affected in different ways by the drop in oil prices, there are also quite a number of similarities: oil-importing countries, particularly among the emerging economies, are reaping the benefits of enhanced purchasing power, lower production costs and improved trade balance. Oil-exporting countries, on the other hand, are experiencing revenue reductions, which is placing pressure on budgets and trade balances. However, the net effect on the global economy is likely to be positive. A report from the IMF estimates that the drop in oil prices will help global GDP to increase by between 0.3 and 0.7 per cent in 2015, compared with a scenario in which the price of oil remains unchanged.[2]

One important reason as to why the drop in oil prices may help to promote global growth is that the price drop is due primarily to an increased supply of oil. Unlike during the financial crisis, when the price of oil fell on account of a decline in demand, a shortage of demand is now not the primary cause of the low price. An increase in the production of shale oil in the USA has contributed to surplus production of oil over the past two years. When the price of oil falls as a consequence of an increase in supply, and not a decline in demand, global activity increases.[3]

Sweden is an importer of oil and will experience an increase in domestic purchasing power and an increase in disposable income as a consequence of the reduced oil prices. However, the extent of the effect is dependent on a number of factors, including the energy intensity in production, which is often less in rich countries such as Sweden than in emerging countries such as China and India.

Another factor which must be taken into account is the fact that oil producer Norway is one of Sweden's most important trading partners. The oil industry constitutes a major proportion of the Norwegian economy: 25 per cent of GDP, 30 per cent of investments, 30 per cent of government income and 50 per cent of

[2] Arezki and Blanchard (2014).
[3] Kilian (2009) and Aastveit, et al. (2015).

exports. The knock-on effects of lower oil prices on the Norwegian mainland economy may, therefore, be major, and clearly negative, in the short and medium term. Most forecasters are now also indicating that growth in the Norwegian economy will be weak in 2015. A calculation based on the analysis in Bjørnland and Thorsrud (2015) indicates that if the price of oil falls by approximately 40 per cent on account of an increase in oil supply, Norway's mainland GDP will fall by approximately 1–2 per cent, compared with a scenario in which the price of oil remains unchanged.

There are signs that activity in the Norwegian economy is now slowing. Forecasts for oil investments in Norway for 2015 have been reduced by 15 per cent compared with the year before, unemployment is increasing although it remains at a moderate level (3.9 per cent), and the Norwegian krone has depreciated by approximately 20 per cent against certain currencies.

Sweden's exports to Norway account for approximately 10 per cent of Sweden's total exports, which makes Norway Sweden's most important export market. A reduction in purchasing power in Norway and a weaker Norwegian krone may involve a reduction in Swedish exports to Norway and hence counteract some of the positive effect of lower oil prices for Sweden. It is still too early to say how great this impact will be, and it is dependent on factors such as how long oil prices remain low.

1.2 Developments in Sweden[4]

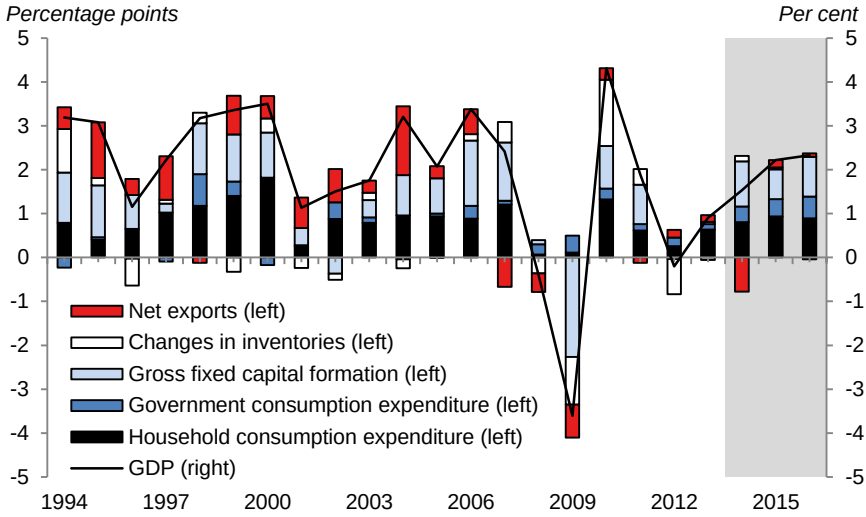
Recovery is continuing in the Swedish economy. Rising employment and real wages, as well as tax reductions, have led to households' disposable income increasing relatively quickly over the past few years. This, in combination with a low interest rate, has encouraged household consumption and housing investments, both of which made significant contributions to growth in 2014 (Figure 1.2).

Disposable income is expected to continue to increase alongside improvement in the labour market situation. Household consumption is expected to rise in line with income. The increasing proportion of elderly people and large numbers of immigrants mean

[4] This section is based on NIER (2015c), Statistics Sweden (2015e), VP15 and OECD (2015a).

that the need for welfare services is growing relatively quickly. Therefore, general government consumption will increase over the next few years.

Figure 1.2 GDP development and expenditure components, 1994–2016



Note: The solid line indicates a change in GDP at constant prices, in relation to the previous year. The columns show how the various expenditure components contributed to the change in GDP.
Source: NIER (2015c).

As the global economy improves, the demand for Swedish export goods will rise more quickly over the next few years. GDP is expected to grow by approximately 3 per cent this year. It seems growth in 2016 could be even higher. Most analysts believe that resource consumption in the economy will return to normal next year. This would herald the end of the prolonged poor economic situation. However, we note that the Government has a rather more pessimistic view of the economic outlook than the National Institute of Economic Research (NIER), for instance. The Government believes that a small economic gap of -0.8 per cent will remain in 2016 and that the economic downturn will end in 2017–2018.

The falling price of oil (Box 1.1) is helping to slow the development of consumer prices (Table 1.1). Low inflation means that monetary policy is still expansionary.

Employment and the labour force grew at approximately the same rate in 2014, which means that unemployment remained at 8 per

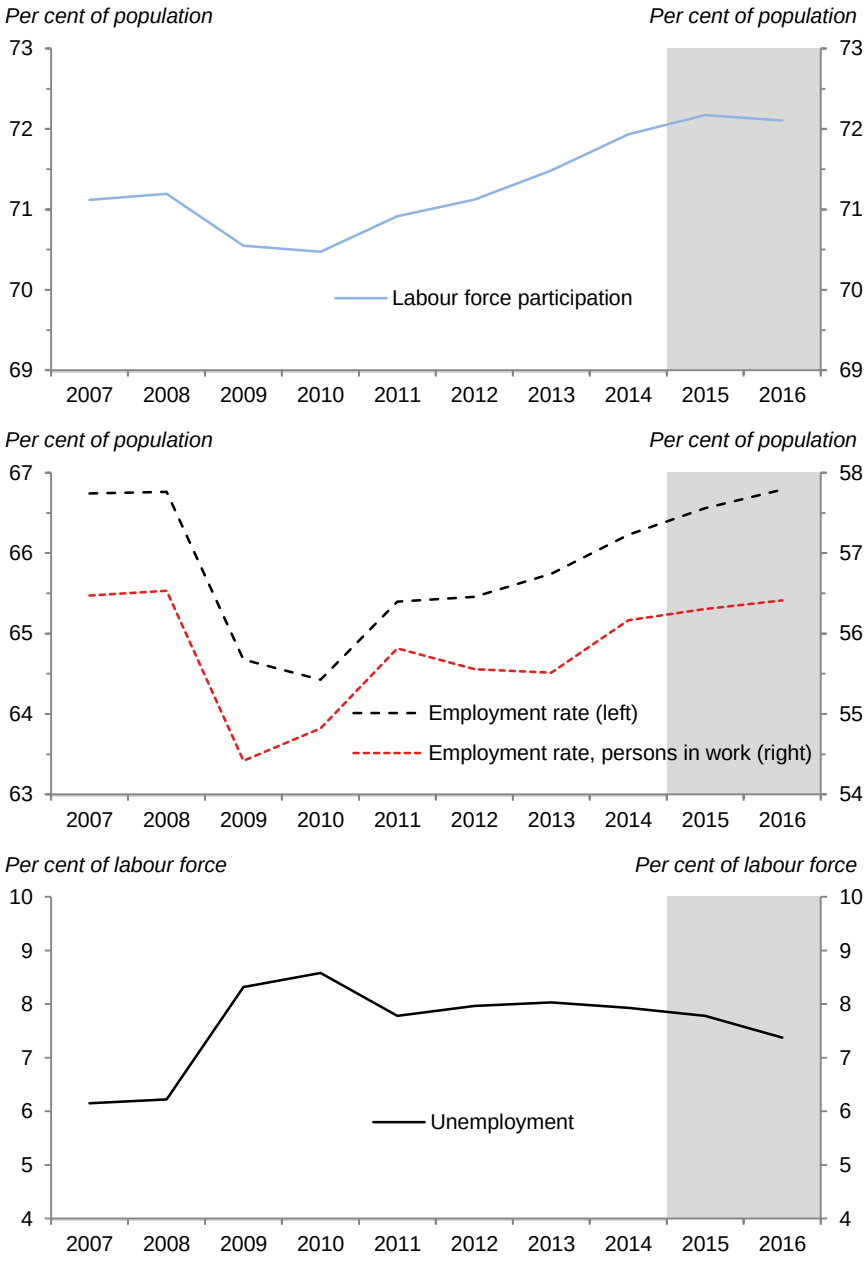
cent. The increase in the labour force is expected to subside slightly over the next few years, while employment will continue to increase. Thus it is believed that unemployment will start to decline in 2015 (Figure 1.3).

Table 1.1 Key macroeconomic indicators for the Swedish economy

	BP15 September 2014			VP15 April 2015		
	2014	**2015**	**2016**	**2014**	**2015**	**2016**
GDP	2.1	3.0	3.2	2.1	2.6	2.7
Output gap	-2.2	-1.2	-0.5	-1.9	-1.4	-0.8
Employed	1.3	1.4	1.2	1.4	1.4	1.3
Unemployment	7.9	7.3	6.7	7.9	7.5	7.1
CPI	0.0	0.9	2.2	-0.2	0.0	0.9
Net lending	-2.2	-1.1	-0.3	-1.9	-1.4	-0.7
Gross debt	40.2	39.5	38.0	43.9	44.2	42.8
	NIER August 2014			**NIER** March 2015		
	2014	**2015**	**2016**	**2014**	**2015**	**2016**
GDP	1.8	3.1	3.4	2.1	3.1	3.3
Output gap	-2.3	-1.5	-0.7	-1.6	-0.9	0.0
Employed	1.2	1.2	1.1	1.4	1.4	1.4
Unemployment	7.9	7.6	7.3	7.9	7.8	7.4
CPI	0.0	1.1	2.2	-0.2	0.2	1.1
Net lending	-2.2	-1.3	-0.5	-2.1	-1.5	-0.9
Gross debt	42.3	41.3	40.4	40.6	41.0	39.9
	Riksbank September 2014			**Riksbank** April 2015		
	2014	**2015**	**2016**	**2014**	**2015**	**2016**
GDP	1.7	3.0	3.1	2.1	3.2	3.4
Output gap	-1.0	-0.1	0.5	-	-	-
Employed	1.3	1.4	1.1	1.4	1.4	1.3
Unemployment	7.9	7.3	6.7	7.9	7.6	7.2
CPI	0.0	1.3	2.9	-0.2	0.3	2.1
Net lending	-2.1	-1.3	-0.6	-2.1	-1.3	-0.7

Note: Output gap is specified as a percentage of potential GDP, unemployment as a percentage of the labour force (aged 15–74) and general government net lending and gross debt as a percentage of GDP. Others are specified as an annual percentage change. Note that NIER's August forecast was compiled before the switching of the National Accounts to ENS 2010.
*The Swedish Riksbank specifies no values for the output gap in its April forecast, but writes that: "It is believed that capacity utilisation will be normal towards the start of 2016 and then be slightly higher than normal".
Sources: BP15 and VP15, NIER (2014a) and (2015c), and the Swedish Riksbank (2014) and (2015).

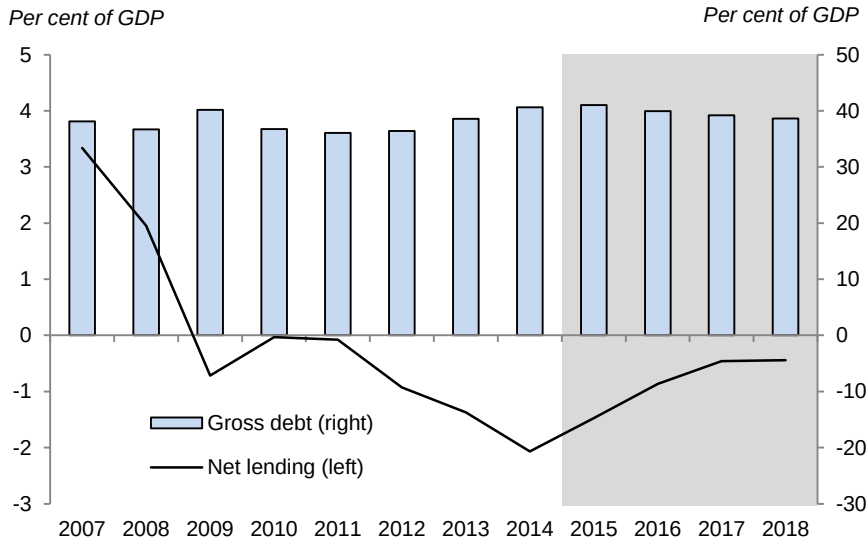
Figure 1.3 Labour force, employment and unemployment



Note: Refers to the 15–74 age group. The rate of employment for people in work refers to employed persons who performed at least one hour's work during the reference week (i.e. were not absent). The years 2015–2016 are a forecast.
Source: NIER (2015c).

According to NIER, Government net lending is estimated to be -1.5 per cent of GDP in 2015. It is estimated that this deficit will be reduced over the next few years as a consequence of a stronger economic situation, provided that no unfinanced reforms take place. The deficits mean that general government's consolidated gross debt is estimated to increase slightly in 2015 but then decline after that (Figure 1.4).

Figure 1.4 Government net lending and gross debt



Note: The years 2015-2018 are a forecast.
Source: NIER (2015c).

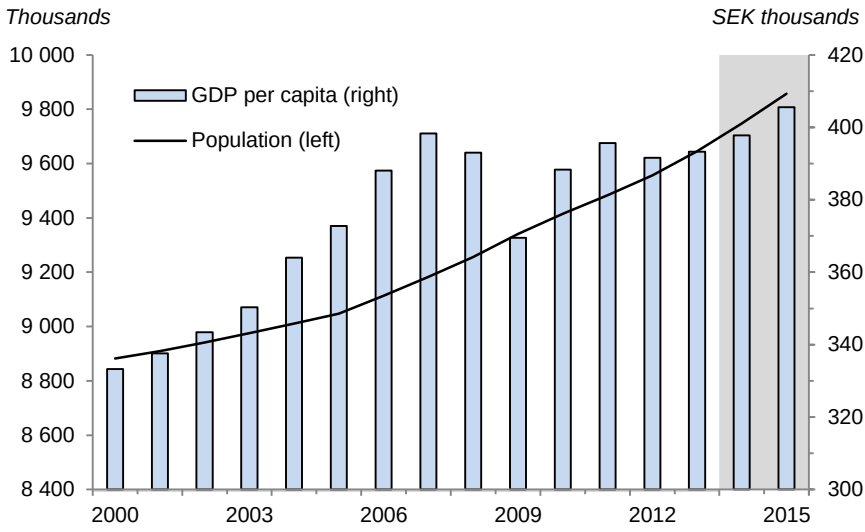
It now appears that an ever stronger global economy could drive Swedish growth over the next few years. Risks for weaker international economic development still remain, but in spite of this the prospects for good economic development in Sweden are better than they have been in a number of years.

1.3 The crisis and productivity

The financial crisis and Euro crisis have been very costly in terms of lost production and employment. Although the Swedish economy has coped relatively well, capacity utilisation has been low for a long time and unemployment has risen to high levels. How GDP per

capita has developed provides a basic description of the development of the Swedish economy during the crisis. Figure 1.5 shows that GDP per capita in 2014 had not yet reached the level it was at in 2007. The fact that GDP per capita has developed weakly since 2008 is explained to some extent by the fact that the population has grown more quickly than previously.

Figure 1.5 GDP per capita and the population

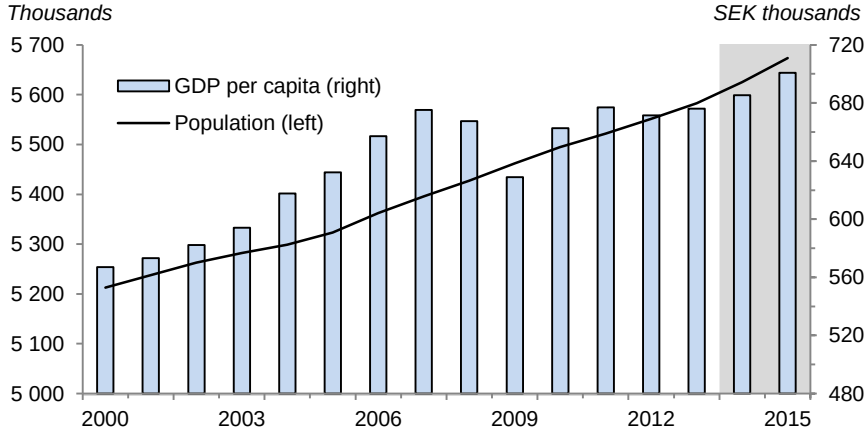


Note: 2013 prices. The years 2014-2015 are a forecast.
Sources: NIER (2015c) and Statistics Sweden SCB (2014) and (2015b).

However, for the formulation of economic policy it is more interesting to examine how the crisis has affected the medium-term growth power of the economy. Economic growth has two sources: it can be increased by investing more resources, i.e. working more hours or using more natural resources or more powerful machines, or it can be achieved by making more of the resources invested, i.e. by increasing productivity. GDP per capita of working age is a better indicator of productivity in the economy than GDP per capita.

Figure 1.6 below shows that GDP per capita of working age rapidly returned to the 2007 level and has been at a slightly higher level than in 2007 for a couple of years. In this respect, development in Sweden is no different to the development in other OECD countries. Figure 1.7 below shows that Swedish development since 2007 is neither better nor worse than in comparable countries.

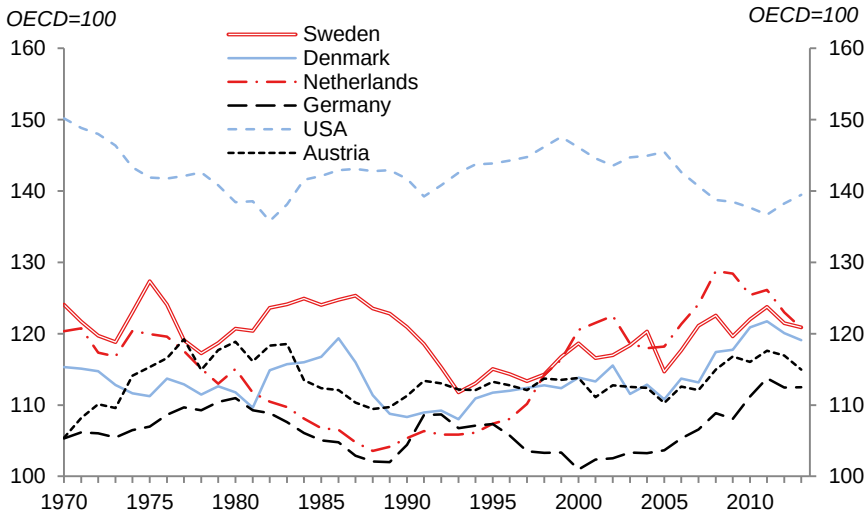
Figure 1.6 GDP per capita of working age and the population (aged 20–64)



Note: 2013 prices. The years 2014-2015 are a forecast.
Sources: NIER (2015c) and Statistics Sweden SCB (2014) and (2015b).

The productivity growth rate determines how the standard of living will develop in the long term. Productivity is determined by the quality of the physical capital, the qualifications of the labour force, the technical development level and the organisation of these production factors. Historically, productivity growth has been the primary source of economic growth.

Figure 1.7 GDP per capita (20–64 age group) in comparison with OECD



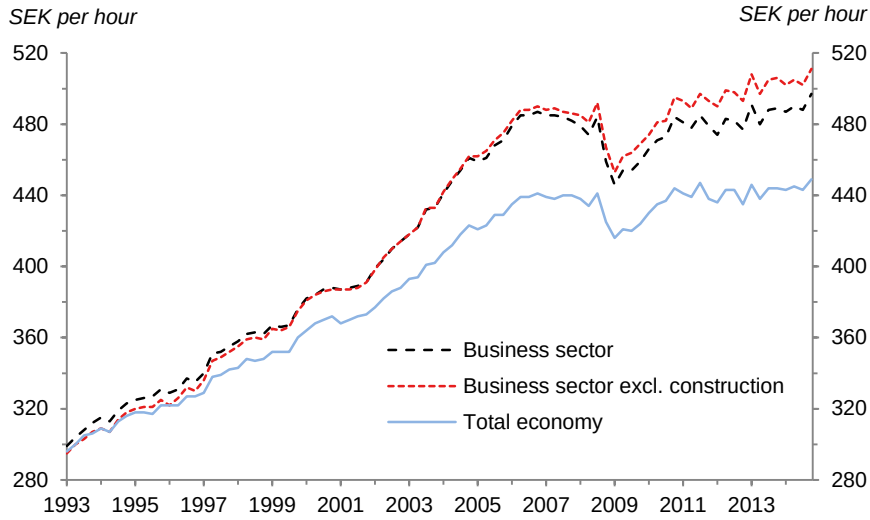
Note: Index of GDP per capita (20–64 age group) adjusted for purchasing power parity in comparison with OECD.
Sources: OECD (2015b) and own calculations.

Labour productivity, which is defined as production volume per hour worked, is the most common indicator of productivity. Higher labour productivity means that more can be produced in a given number of hours worked and that fewer hours are required to achieve a certain production volume.

Figure 1.8 below shows that labour productivity in Sweden fell very sharply when the crisis began and has developed weakly since then. Certainly, productivity growth had already begun to tail off before the crisis, but it is possible that the Swedish economy has suffered permanent harm on account of the financial crisis and Euro crisis.[5] That said, the Swedish situation is not unique. A lively international debate is ongoing concerning the long-term effects of the crisis and the prospects for economic growth.[6]

[5] Between 1993 and 2007, labour productivity for the entire economy grew by 2.7 per cent per year on average. The growth rate between 2007 in 2014 was 0.2 per cent per year. If this decline were to become permanent, it would now take 350 years for the economy to double, compared with the 26 years it would take for the economy to double at a growth rate of 2.7 per cent per year.
[6] See IMF (2015b), for example.

Figure 1.8 Labour productivity in the economy



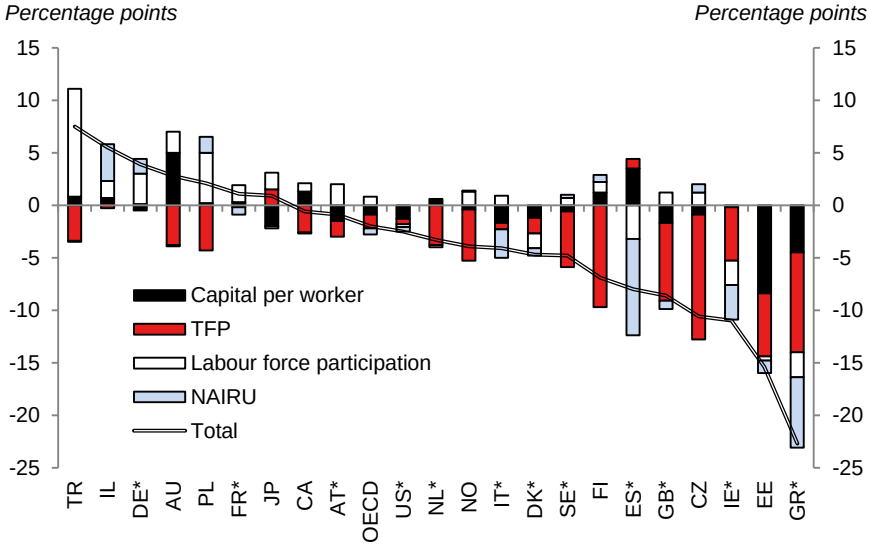
Note: Seasonally adjusted, calendar adjusted quarterly values in constant prices (reference year 2013).
Sources: Statistics Sweden (2015d) and own calculations.

As far as economic policy is concerned, how much of the weaker growth will remain once the economic situation has recovered is a central issue. However, it is impossible to give a definitive answer to that question. After all, we do not know how things would have developed had the crisis not struck. Nor is it possible to clearly separate the effects of the crisis on development from other changes in society such as new economic policy. Every attempt to estimate the loss must be regarded as preliminary.

In a study, the OECD has recently attempted to estimate the effects of the crisis on growth.[7] This study makes an assumption of how GDP would have developed had there been no crisis. The actual development is then compared with this imaginary growth trajectory, so providing an indicator of the effect of the financial crisis on the economy. This study is summarised in Figure 1.9 below.

[7] Ollivaud and Turner (2014).

Figure 1.9 The effect of the crisis on potential production, decomposed according to the OECD



Note: Relates to the OECD's estimate of the effect of the crisis on potential production compared with a counterfactual scenario in which trend productivity is developed in line with the trend growth rate during the period prior to the crisis (2000–2007), the structural unemployment is constant at the 2007 level and the trend labour force participation is projected with demographic development. The figure above decomposes the total change in contributions from capital per worker, total factor productivity (TFP), labour force participation and structural unemployment (NAIRU).
*Countries deemed to have undergone a banking crisis between 2007 and 2011.
Source: Ollivaud and Turner (2014). For a list of the country codes, see Eurostat (2012).

Most OECD countries have been adversely affected by the crisis. As can be seen in Figure 1.9, Sweden is one of the countries which has been significantly affected by the financial crisis and Euro crisis. According to the study, Swedish productivity has deteriorated by almost six per cent during the crisis years, compared with an imaginary growth trajectory without the crisis. Much of this deterioration is due to weaker total factor productivity (TFP).[8] In this respect, development in Sweden is not particularly different to other countries. Impaired total factor productivity is something which has affected the majority of OECD countries, which indicates that the low productivity and element seen in Sweden over the last few years

[8] The total factor productivity (TFP) indicates the productivity for an overall index of production factors (labour force and capital in this study). The higher the total factor productivity, the higher the GDP for a given quantity of production factors.

is not a specifically Swedish problem. At the same time, Swedish development during the years of crisis has involved increased labour force participation and lower equilibrium unemployment, which will improve growth prospects in future. However, all in all the study finds that factor productivity has been massively weakened in the medium term during the years of crisis.[9]

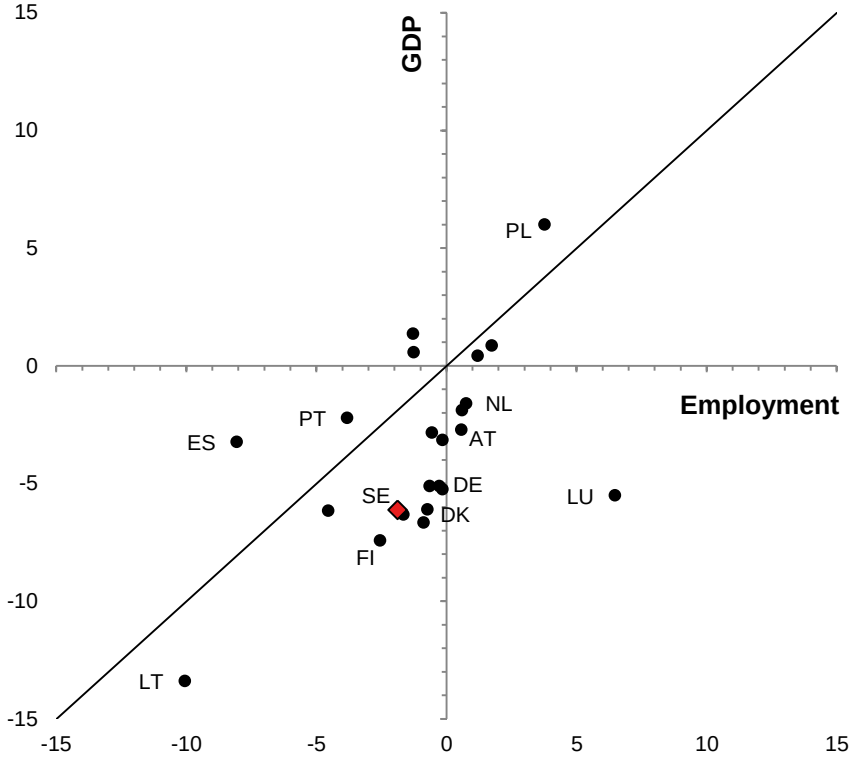
The fact that labour productivity declines during a recession is not necessarily an expression of fundamental changes in the economy. In general terms, labour productivity normally develops procyclically in that the change in production exceeds the change in employment. This pattern can be perceived in a number of European countries during the financial crisis. One explanation for this is that companies retain their workforces during a crisis if they are expecting the demand shock to be temporary.[10] However, in countries such as Spain, Portugal and Ireland it may be noted instead that employment fell considerably more than production during the crisis, i.e. productivity developed contracyclically in these countries. Figure 1.10 below presents these patterns clearly. In Spain and Portugal, for example, GDP fell slightly during the acute phase of the crisis while employment fell drastically at the same time (the points for Spain and Portugal are located in the third quadrant above the 45–degree line). In Sweden, Germany and Denmark, on the other hand, GDP fell significantly while employment was reduced marginally (the points for Sweden, Germany and Denmark are located below the 45–degree line, near the vertical axis).

[9] It is possible that this study overestimates the negative effect on total factor productivity (TFP). It may be the case that the TFP used as a benchmark is based on an economic boom situation and therefore constitutes too high a reference value.

[10] This phenomenon is known in the literature as "labour hoarding"; see EEAG (2014).

Figure 1.10 Change in GDP and employment during the crisis

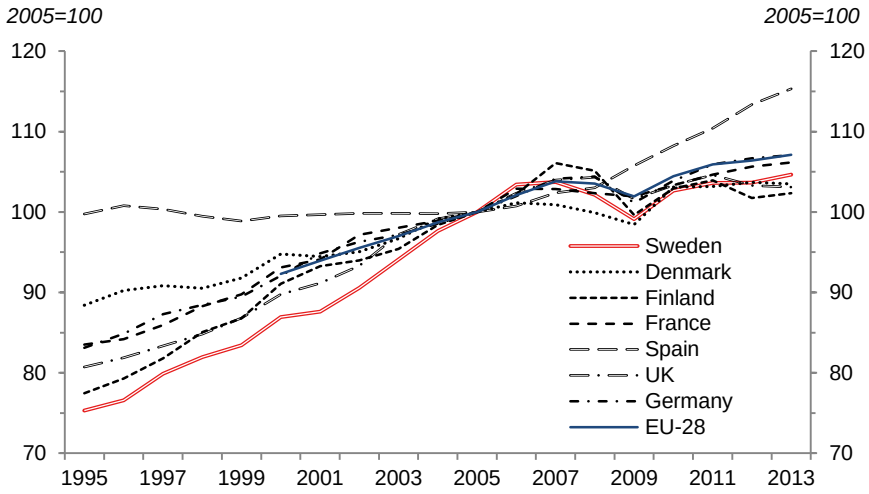
Percentage change



Note: The vertical axis shows the percentage change in real GDP between the third quarter of 2007 and the third quarter of 2009 (seasonally adjusted, calendar adjusted values). The horizontal axis shows the percentage change in employment for the same period. GDP has developed more strongly (more weakly) than employment in countries located above (below) the 45–degree line.
Sources: EEAG (2014), Eurostat (2015) and own calculations. For a list of the country codes, see Eurostat (2012).

This pattern is apparent in Figure 1.11 below as well, which shows how labour productivity has developed over a length of time: Spain had very weak productivity growth before the crisis, but after 2007 this has been strong. The pattern is reversed for Sweden.

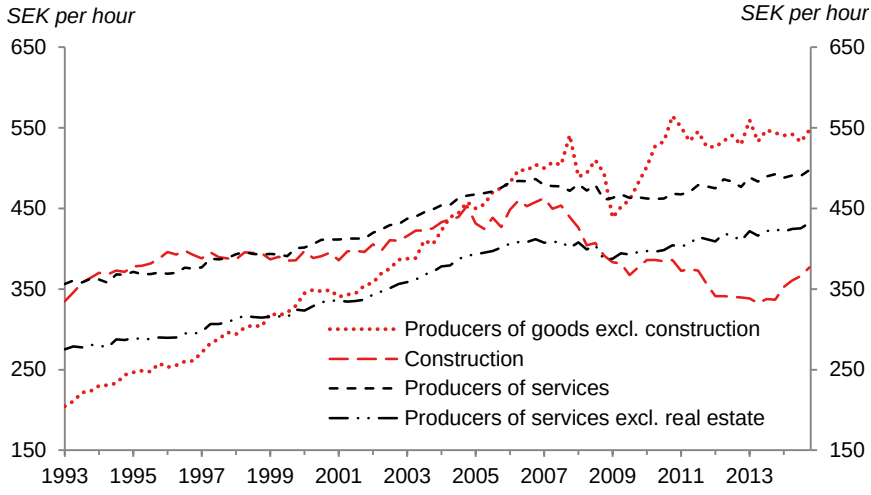
Figure 1.11 Labour productivity in the economy



Source: OECD (2015b).

Productivity development varies in different industries. This is why an indicator of productivity which includes the entire economy (which labour productivity does) conceals development within the various sectors in the economy. Figure 1.12 clearly indicates the difference in development in various parts of the Swedish economy.

Figure 1.12 Labour productivity in various sectors



Note: Seasonally adjusted, calendar adjusted quarterly values in constant prices (reference year 2013).
Source: Statistics Sweden (2015d).

The productivity measured among product manufacturers fell significantly during the crisis, followed by a recovery and then relatively stagnant productivity development. The construction sector has experienced declining productivity throughout much of the period after 2007. Service providers were by no means affected to the same extent during the crisis, and since then they have seen a continued productivity increase (albeit at a lower level than the product manufacturers).

Besides productivity changes in various industries, the composition of the economy is also changing over time: general government has declined, but in particular the service industries have increased as a percentage of the total number of hours worked in the economy (Table 1.2).

Table 1.2 Hours worked in the economy, by sector

Per cent	**1993**	**2000**	**2007**	**2014**
Producers of goods	29.4	29.3	27.4	24.7
Producers of services	37.9	41.1	42.8	46.1
Public sector	32.7	29.6	29.8	29.2

Note: Relates to each sector's share of the total number of hours worked in the economy. Public sector refers to public authorities and households' non-profit organisations.
Source: Statistics Sweden (2015d).

Therefore, one partial explanation for the weak productivity development over the last few years could involve the fact that the service providers – who generally have a lower rate of productivity increase than product manufacturers – have increased their share of hours worked in the economy.

To see whether the change in the composition of the economy can explain the weak productivity growth, we will carry out an analysis of how productivity would have developed had the industry composition[11] in the economy remained constant since 1993. When each industry's share of the hours is kept constant, this results in stronger development for the hours of the product manufacturers and general government than is actually the case. At the same time,

[11] Grouped according to: (1) industry, (2) construction, (3) agriculture + supply of electricity/gas/heating, etc., (4) commerce, (5) transport/warehousing, (6) ICT, (7) finance and insurance, (8) property services, (9) law, economics, technology, etc., (10) other household services (hotels, restaurants, training, care, culture, etc.), (11) public sector.

the hours of the service providers develop more weakly than is actually the case. In all, the adjustment for industry composition means that the rate of productivity increase rises (Table 1.3). However, there are no major differences. Therefore, the fact that productivity growth has slowed over the past decade does not appear to be due to any great extent to the fact that the service-providing sectors in the Swedish economy have grown in significance.

Table 1.3 Average annual percentage change in productivity

		Total economy	Business sector
1993–2007	Actual	2.3	3.0
	Adjusted	2.3	3.2
2008–2009	Actual	-2.1	-3.3
	Adjusted	-2.1	-3.3
2010–2014	Actual	1.0	1.5
	Adjusted	1.2	1.8

Sources: Statistics Sweden (2015d) and own calculations.

To summarise, we can state that the productivity growth in the Swedish economy has been weak for almost a decade. The financial crisis and Euro crisis, and the low demand prevailing since the acute phase of the crisis, are probably the most important explanations for this. When other countries recover 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. Here, we would also like to point out an alarming development tendency: the weak development of productivity in the construction industry.[12] In earlier reports, we have emphasised the need to reform housing policy.[13] There is a major need for housing, particularly in the metropolitan regions. Hence it is worrying to see that productivity in the construction sector has developed so weakly. The measured

[12] A debate is ongoing as to whether productivity development in the construction industry is being underestimated on account of systematic measurement errors; see, for example, Lind and Song (2012). It is not possible to rule out the fact that measurement problems may partly explain the low productivity figures for the construction industry. However, it seems very unlikely that measurement problems would be the only explanation for the low productivity development in the construction industry.

[13] See, for example, Fiscal Policy Council (2013).

labour productivity in the construction sector is now lower than it was in 1995.

1.4 Income distribution 1995–2013

In this section, we will be supplementing the description we provided in last year's report of the development of income distribution between 1995 and 2012, with new statistics for 2013. We will also be discussing differences between statistics from Statistics Sweden and Eurostat and examining whether this provides a consistent view of how income distribution has developed over time.

1.4.1 Development of income distribution

As in previous reports, we will be using Statistics Sweden's survey of Household Finances (HEK) to describe the development of income distribution in Sweden.[14] In last year's report, we concluded that incomes at the top and bottom of the income distribution have been increasing more slowly than those in the middle since 2006. This has led to reduced income dispersion at the top of the distribution and increased dispersion in the lower part of the distribution. We will now be adding information on incomes in 2013 to that description.

Figure 1.13 below shows the average income level in 2013 prices for each of the ten decile groups in the population and the average for all inhabitants of Sweden.[15] The figure shows both actual income growth (which includes realised capital gains) in real terms for different income groups and the differences between various income groups.

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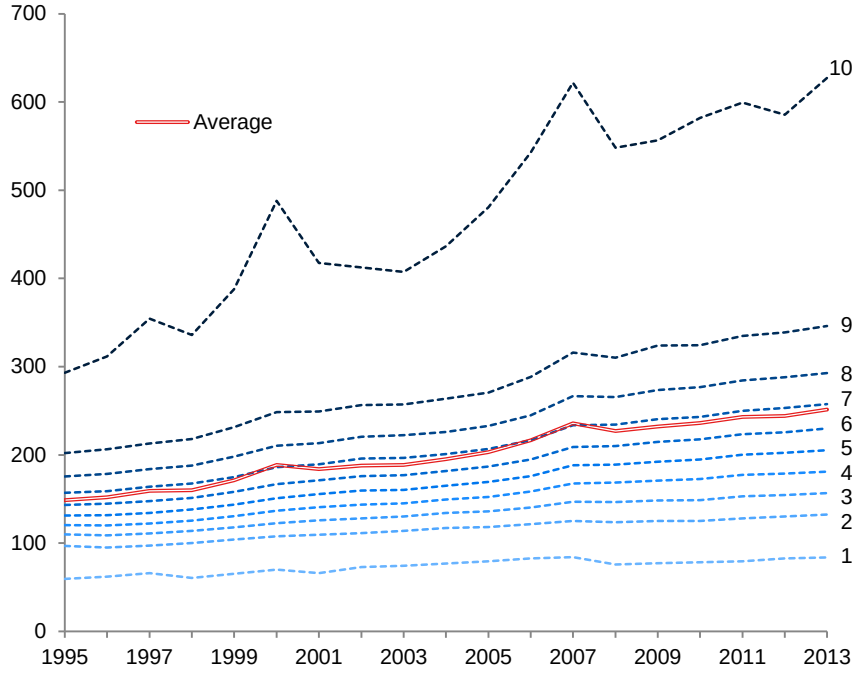
[14] HEK has provided Sweden's official income distribution statistics since 1975, but other databases also exist. For example, it is possible to monitor the incomes of individuals over long periods using the Statistics Sweden database LINDA. Since the 2014 survey year, HEK has been replaced by total estimated income statistics (TRIF); see Statistics Sweden (2015f).

[15] Decile group is a statistical concept whereby the first decile group in an income context consists of individuals below the tenth percentile in disposable income. The second decile group consists of those between the 10th and 20th percentile, and so on. The 10th decile group is the highest income group and consists of those above the 90th percentile. A percentile is the income under which a specific per cent of the incomes in the distribution fall. Thus, for example, the 10th percentile is that part of an income distribution where 10 per cent of incomes are lower than the percentile and 90 per cent are higher. The median is called the 50th percentile as exactly 50 per cent of individuals have an income below this percentile. In 2013, the disposable median income (50th percentile) amounted to SEK 217,200. The 10th percentile in 2013 amounted to SEK 117,200, and the 90th percentile amounted to SEK 387,500.

Figure 1.13 Disposable income per capita

SEK thousands



Note: Refers to average adjusted disposable income, including realised capital gains, by decile group (in SEK thousands). Incomes are estimated in 2013 prices. Since Statistics Sweden's data sets cover a cross-section of the population, the decile groups do not necessarily consist of the same people each year.
Source: Statistics Sweden (2015c).

Figure 1.13 indicates that the average income has increased in all decile groups between 2012 and 2013. The greatest increase has taken place in decile group 10. This increase amounts to 7.2 per cent, which can be compared with the lowest income increase between 2012 and 2013 (1.2 per cent for decile group 1). On average, incomes for all decile groups increased by 3.0 per cent between 2012 and 2013.

Table 1.4 below presents the same statistics as in Figure 1.13. In this table, we report the period 2006–2013 separately; i.e. development in seven of the eight years in which the Alliance parties were in office.

In section 1.3, we saw that GDP per capita has developed very weakly since 2007. It had still not reached the 2007 level by 2014. Despite this, households' disposable incomes have grown. Table 1.4

shows that all decile groups on average have undergone positive disposable income development since 2007. The tax reductions implemented during and after the crisis are an important explanation for this. With these tax reductions, resources have been redistributed from general government to households. Public finances have weakened as general government consumption has not been reduced to a similar extent. These tax reductions explain almost half of the difference in growth rate between households' disposable income and GDP per capita. The rest of the difference is mainly explained by the fact that households' earned incomes have grown more quickly than trade and industry's profit share of the added value.[16]

Table 1.4 Change in disposable income

Percentage change	**1995–2006**	**2006–2013**	**1995–2013**
Decile group 1	39.4	1.2	41.1
Decile group 2	25.7	8.9	36.9
Decile group 3	28.0	11.5	42.7
Decile group 4	31.6	14.3	50.4
Decile group 5	34.1	16.7	56.6
Decile group 6	36.0	18.1	60.5
Decile group 7	37.7	18.9	63.7
Decile group 8	39.5	19.6	66.8
Decile group 9	42.9	20.0	71.5
Decile group 10	85.2	15.6	114.1
All decile groups (average)	45.6	16.0	68.9
Median	34.7	17.7	58.5

Note: Refers to aggregate percentage change in average adjusted disposable income, including capital gains, per capita (2013 prices) by decile group.
Sources: Statistics Sweden (2015c) and own calculations.

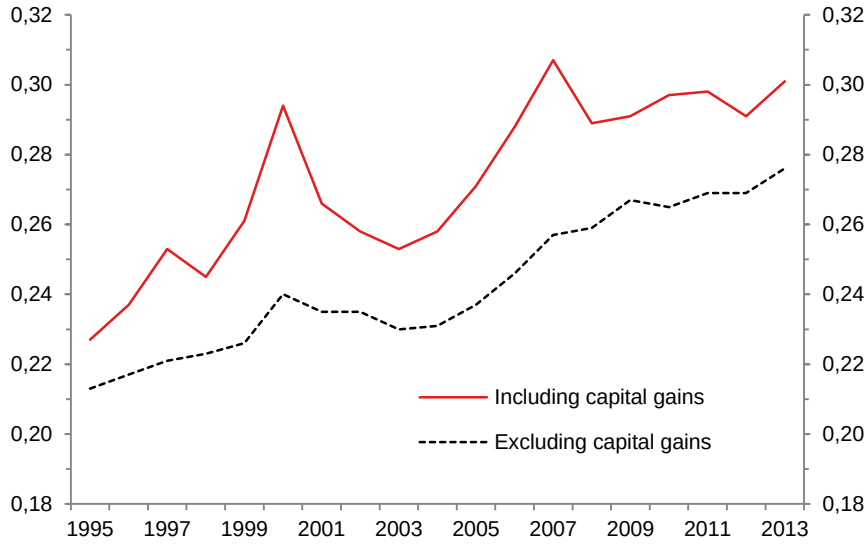
Table 1.4 clearly indicates that households with the lowest incomes (decile groups 1 and 2) have seen considerably weaker income development than other groups since 2006. We can also see that the median income since 2006 has grown more quickly than the average incomes in decile groups 1 to 5. In other words, the distance between the incomes in the lower half of the income distribution and

[16] See the National Institute of Economic Research (2015c), pp. 21–22.

the median income has increased. At the same time, the incomes in decile groups 6 to 9 have grown more quickly than the median income. In this part of the income distribution, the distance to the incomes in the lower half of the income distribution has increased and approached the incomes in decile group 10, where incomes have grown slightly more slowly than the median income.

The Gini coefficient is normally used to gain an overall view of changes in income distribution. This can adopt values between zero and one: the lower the value, the more even the income distribution.[17] As the Gini coefficient is a distribution measure, Figure 1.14 below says nothing about how the absolute income level in Sweden has developed between 1995 and 2013. The figure shows how income dispersion has changed for two income concepts: disposable income with and without realised capital gains.

Figure 1.14 Gini coefficient for disposable income



Note: Refers to the Gini coefficient for adjusted disposable income.
Source: Statistics Sweden (2015c).

[17] The Gini coefficient indicates the share of the income total that has to be redistributed in order to achieve a completely even income distribution. The Gini coefficient assumes the value zero when everyone in the population has the same income and the value one when all the income in society goes to one person.

The figure shows an upward trend in disposable income differences from 1995 to about 2007. The approximate size of the increase is from 0.23 to 0.31 up to 2007 when realised capital gains are included, and from 0.21 to 0.26 when these gains are excluded.[18] Further, it may be stated that the Gini coefficient for the disposable incomes has not changed at the same rate after 2007 compared with previously: it has remained unchanged if capital gains are included and has increased from 0.26 to 0.28 if these are excluded. This may seem strange, given the changes between various decile groups that we saw in Figure 1.13 and Table 1.4. However, the Gini coefficient is not as susceptible to changes on the periphery of the income distribution as to changes in the central area of the distribution. Therefore, it is interesting to supplement the analysis with other income dispersion measures.

Table 1.4 shows that incomes in decile group 1 barely changed at all, and that incomes in decile groups 2 to 5 grew more slowly than the median income between 2006 and 2013. These changes are clearly apparent when examining how relative poverty has developed over these years. The relative poverty measure shows the percentage of the population with less than 60 per cent of the median income in the income distribution, and this is also a distribution measure. With a relative definition of poverty, the level of real purchasing power at which a person is defined as poor may change from one year to the next.

Figure 1.15 shows how relative poverty in Sweden developed between 1995 and 2013. Relative poverty has almost doubled in Sweden since 1995: from 7.3 per cent to 14.1 per cent. The figure shows that the rate of increase rose sharply after 2006, levelling out in around 2011–2012. This development is also apparent from Figure 1.13 and Table 1.4. As incomes increased less in the lower part of the income distribution, primarily after 2006, the percentage of those with incomes below the relative poverty threshold has increased.

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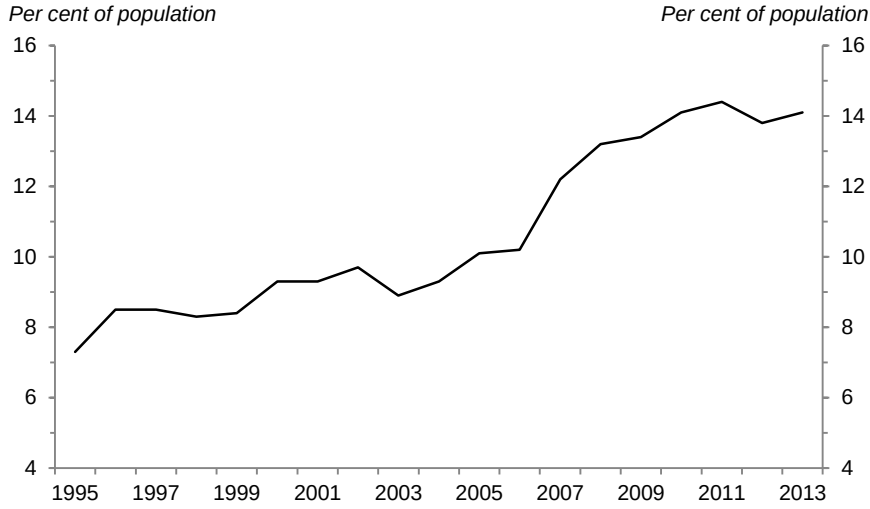
[18] The Gini coefficient has a mathematical property that is useful when interpreting changes in the coefficient. Multiplying the coefficient by two gives a measure of the expected percentage income difference between two people selected at random in the population. The increase in the Gini coefficient from 0.23 to 0.31 means that the expected relative income difference between two people selected at random in Sweden has increased from 46 per cent of average income to 62 per cent of average income.

Figure 1.15 Relative poverty



Note: Relates to the number of people in the population who are living in a household with a disposable income per consumption unit of less than 60 per cent of the median value for all individuals. The relative poverty threshold for 2013 amounted to SEK 130,320.
Source: Statistics Sweden (2015c).

1.4.2 Development of income distribution according to Statistics Sweden and Eurostat

One way of providing perspective on income distribution and its changes is to make international comparisons. Since Sweden became a member of the EU, demands have increased for economic statistics comparable between member states. Within the EU cooperation, comparisons of economic development in the member states are an instrument used to follow up various measures and identify good examples of what can be done to achieve a desired development. This also applies to income distribution issues.

In international income distribution comparisons, the statistics being based on comparable data is a central aspect. Statistics compiled by the OECD and Eurostat, the EU Commission's statistical office, have been used for the most part in the Swedish debate. The statistics for Sweden reported by the OECD are based on HEK. In 2003, Eurostat began compiling data with a view to comparing living conditions within the EU. The member states are responsible for gathering and processing these statistics. HEK does not provide the source for these statistics. This survey is designated

EU-SILC (EU Statistics on Income and Living Conditions). EU-SILC is carried out each year and makes it possible to compare information on income, poverty, social exclusion, accommodation, labour, education and health at both household and individual level between different countries. The statistics have been used since 2010 to follow up and evaluate the EU's 2020 strategy.

The Government has been reporting comparisons of various measures of income dispersion between Sweden and other European countries based on data from EU-SILC for a number of years.[19] The picture painted by these comparisons deviates from the picture of development in Sweden painted by HEK. Therefore, the Council asked Statistics Sweden to perform a number of calculations so as to make it easier to understand the differences between statistics from HEK and statistics from EU-SILC.

The methods for gathering and processing data in HEK and EU-SILC differ in a number of respects. The surveys use different income concepts and equivalence scales.[20] There are also significant differences in respect of sample, sample size and data processing.[21] The Council asked Statistics Sweden to perform calculations of the Gini coefficient based on HEK data, but with the income concept and equivalence scale used in EU-SILC. The aim was to clarify whether these differences in method could explain the differences in the view of how income distribution has developed over time.

Figure 1.16 below shows various Gini coefficient calculations. The figure shows that the Gini coefficient is lower throughout if the EU-SILC equivalence scale and income concept are used rather than the HEK equivalence scale and income concept, despite the fact that basic data is provided by HEK in both instances. The difference between the Gini coefficients calculated in the two different ways

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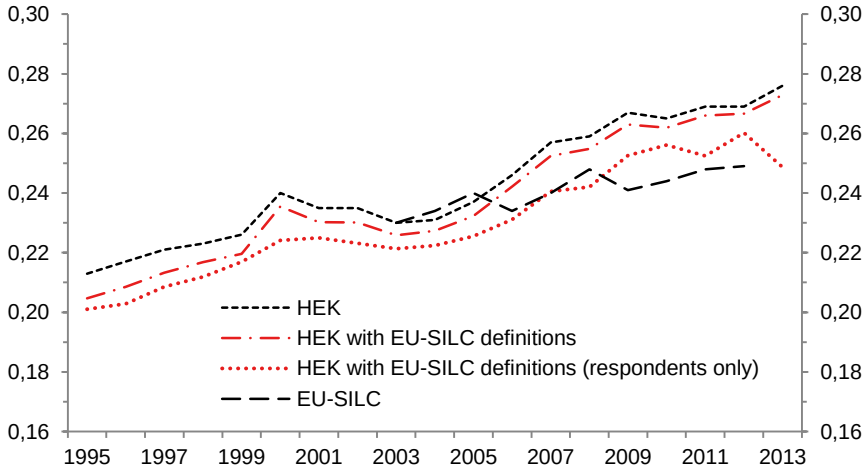
[19] BP08 uses statistics from EU-SILC for the first time in the income distribution report. The Government used to use statistics from the OECD for international comparisons.

[20] The equivalence scale (or consumption unit scale) is an index permitting comparisons between households of different compositions (number of members in the household, ages, place of residence, etc.).

[21] In EU-SILC, the calculation of income distribution – for example – is based solely on data from respondents, while the income distribution statistics in HEK are based on the *entire* sample. This means that both response and non-response households/individuals are included in the estimates of the Gini coefficient in HEK, for example; which is not the case with EU-SILC, where only data from respondents is included. Household composition is imputed for the non-response in HEK with the help of registered details. The response frequency in EU-SILC stands at around 55 per cent, and at just over 50 per cent in HEK. Source: Statistics Sweden.

remains largely unchanged over time. If, on the other hand, we only include people who responded in HEK – i.e. we do not include data for the individuals for whom Statistics Sweden has sought out details in various registers – the Gini measure calculated according to EU-SILC deviates clearly from the other two curves. Likewise, the Gini coefficient calculated entirely according to EU-SILC deviates clearly from other series: the measure varies slightly at around 0.24 from 2004 until 2012.

Figure 1.16 Gini coefficient for disposable income excluding capital gains according to HEK and EU-SILC



Note: HEK with EU-SILC definitions is calculated using Statistics Sweden's HEK data, but using EU-SILC's concept and equivalence scale. "Response only" is calculated exclusive of non-response in the survey.
Sources: Statistics Sweden (2015c) and Eurostat/EU-SILC (2015).

The difference between the Gini measure according to HEK and EU-SILC cannot be explained by the fact that the surveys use different income concepts and equivalence scales. The explanation probably lies in how data is processed, along with differences in sample methodology. The previous Government argued that the differences in the calculation of the Gini coefficient are due to the fact that different equivalence scales are used and that this difference

does not impact upon the overall view of income distribution.[22] This statement does not appear to be correct. However, we do not know which statistics provide the most accurate view of income distribution. The Council is of the opinion that the Government should examine in greater detail why the statistics in HEK and EU-SILC do not provide a consistent view of how income distribution has developed over time.

1.5 Assessments and recommendations

According to most analysts, capacity utilisation in the Swedish economy will achieve equilibrium in 2016. This will herald the end of the prolonged poor economic situation. Even the Government's slightly more pessimistic assessment indicates that the economy will come close to equilibrium next year.

However, risks of weaker international economic development continue to be significant. The low interest rates have driven up asset prices, and any new turmoil in central government finances in the Eurozone could cause an abrupt price drop. The limited scope in central government finances in the Euro states will make it difficult for them to deal with the consequences of any such price drop. There is then a risk of demand falling throughout Europe. Geopolitical uncertainty also remains high. Despite these risks, the prospects for good economic development are better than we have seen in several years. As far as Sweden is concerned, this means that financial policy must be adapted to ever-increasing capacity utilisation.

The Council notes that the measured productivity increase in the Swedish economy has been weak for almost a decade. We do not entirely share the Government's view that trend productivity has been weakened. The financial crisis and 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

[22] In VP08 (Appendix 3, p. 12), the then Government wrote: "Calculations of the Gini coefficient by Eurostat and the Ministry of Finance differ slightly, primarily as a consequence of the use of different equivalence scales. Although this means that the figures are not exactly the same, this does not mean that the overall view is changed". In VP15 (Appendix 2, p. 14), the present Government writes: "Calculations of the Gini coefficient by Eurostat and the Government are not entirely comparable due to differences in respect of data and method selection".

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.

The figure shows an upward trend in disposable income differences from 1995 up to about 2007. Development since then is not as clear. As measured with the Gini coefficient, the income dispersion has remained largely unchanged since 2007. The percentage of people in absolute poverty has remained approximately constant, while the percentage 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. The lowest incomes on average have remained nearly constant for a number of years.

The Council wishes to call the attention of the Government to the fact that the income distribution statistics from Statistics Sweden and EU-SILC provide differing views of development over the past few years. The Government should examine why the statistics do not provide a consistent view of income distribution in Sweden.

2 Fiscal policy 2014–2018

The political situation occurring after the election in September 2014 resulted in the Government's budget proposal for 2015 failing in the Riksdag. Instead, the biggest opposition motion won the support of the Riksdag. We will be describing this process briefly in this chapter, as well as looking at the Riksdag's decision on which economic policy is to apply in 2015. We will also be describing the 2015 Spring Fiscal Policy Bill (VP15), as well as what is known as the Spring Amending Budget for 2015 (VÄB15) submitted by the Government at the same time as the Spring Fiscal Policy Bill on 15 April 2015.

In this chapter, we will be continuing to look at how we view the fiscal stance and the relationship to the surplus target and expenditure ceiling.

2.1 The Government's proposals, the Riksdag's decision and the job of the Council

The Government's proposal was rejected at the Riksdag's vote on the budget on 3 December 2014, and instead the Alliance's budget motion[1] was upheld with the support of the Sweden Democrats. With this occurred a unique situation whereby the Riksdag made a decision on a budget different to the one proposed by the Government, and the Government was therefore tasked with administering a budget for 2015 which it did not back.

The Prime Minister then stated that he was intending to announce a snap election as soon as was constitutionally possible, which was on 29 December. However, shortly beforehand – on 26 December – all Riksdag parties except for the Left Party and the Sweden Democrats concluded an agreement which allowed minority governments to push their budget proposals through.[2] The agreement is to be applied for the first time during the Riksdag discussion of VP15 and VÄB15. In other words, the agreement will not affect the Riksdag's decision to adopt the Alliance's budget proposals for 2015. That said, the agreement provided major opportunities for the Government to

[1] Motion 2014/15:3002.
[2] See section 2.5 for a more detailed comment on the December Agreement.

amend economic policy in connection with VP15 and VÄB15 in April.

This is a situation which was not predicted in the Council's instruction. The Council, in accordance with its instruction, is to review and evaluate the extent to which the fiscal and economic policy objectives proposed by the Government and decided by the Riksdag are being achieved. Thus it is assumed in the Council's instruction that the policy proposed by the Government is the same policy as the one backed by the Riksdag.

The Riksdag's budget decisions have different effects on different areas. Rule changes which were present in BP15 and proposed to come into force on 1 January were not implemented. For example, there was no reduction of earned income tax credits for monthly incomes in excess of SEK 50,000 as proposed by the Government, nor was there any discontinuation in the reduction of social security contributions for people under the age of 26, known as the youth rebate. The Government proposed raising the ceiling for unemployment insurance and proposed initiatives for what are known as trainee jobs and additional services in general government. All of these measures were stopped as a consequence of the Riksdag's decision. In other areas, the Riksdag's decision involved a certain focus on the policy or – as in the case with the reduction in social security contributions for young people – an announcement stating that the Government would return with proposals for changes.[3]

Naturally, an opposition budget is based on less detailed data than a budget bill, and proposals for motions often require continued preparation once the Riksdag has made a decision. A secretariat of the Riksdag has the support of the Riksdag's research service when devising its budget alternative, but even so they do not have the resources required to carry out their own macroeconomic calculations or thorough analyses of the proposals. The opposition parties base their budget alternatives on the same fundamental view of economic development and the development of central

[3] The Government submitted a bill on 22 January concerning changes to Social Security contributions in accordance with the wishes of the Riksdag (Bill 2014/15:50), and the Riksdag backed this proposal. The changes will enter into force on 1 May 2015. In VÄB15, the Government then submitted a proposal indicating that the reduction of social security contributions for young people would be phased out in two stages, commencing 1 August 2015.

government finances as the Government and calculate their proposals as differences against the Government. Therefore, the budget on which the Riksdag has made a decision is predominantly based on the calculations and forecasts of the bill. The Council's analyses of the economy, economic situation, labour market, etc. are therefore based on the budget bill even though this was rejected by the Riksdag.

The December Agreement means that the Government can count on the support of the Riksdag for VP15 and VÄB15. VP15 also saw the reappearance of a number of proposals included previously in the budget bill. A reduction in what is known as the youth rebate was proposed from 1 August 2015, and an increase in the remuneration in the unemployment insurance scheme was proposed from the same time. For practical reasons, some tax rules can only be amended at the end of the year, such as reduction in the earned income tax credit and a change in tax for pensioners. As a consequence, such changes were not proposed in VP15.

2.2 The surplus target

2.2.1 The budget bill

The Government and the Council have previously had differing opinions on whether there is any deviation from the surplus target. The Council stated in its 2013 report that there was a deviation, and repeated this assessment in the 2014 report. For its part, the Alliance Government maintained that there was no such deviation. In VP14, the then Government wrote that "fiscal policy is well calibrated, in line with the fiscal framework and meets the surplus target".[4] With this, the Government expressed its opinion that the deviation of net lending from the target level of 1 per cent was justified by the economic situation.

In BP15, the present Government expressed a completely different opinion. In BP15, net lending was estimated to amount to approximately 0.7 per cent of GDP lower per year between 2014 and 2018 compared with VP14, and structural net lending was also

[4] VP14, p. 34 and p. 139.

estimated to be lower to about the same extent. However, the downward adjustment of the forecast for public finances took place as early as the summer, and government net lending in BP15 was almost the same as that presented by the then Minister of Finance in August 2014[5], but which at the time was not deemed to deviate from the fiscal framework. Thus the new Government's opinion that the fiscal framework had been breached was, to an extent, a result of lower forecasts for net lending, but primarily in different opinion of a similar situation in respect of central government finances. This clearly illustrates something which the Council has highlighted on a number of occasions, namely the fact that the follow-up of the surplus target leaves far too much scope for interpretations. Clear principles concerning the follow-up of the target would have made it less likely for two governments to have been able to assess compliance with the targets in completely different ways.

The Government stated in BP15 that there was a clear deviation from the surplus target level of 1 per cent net lending over an economic cycle, and that this breached the fiscal framework.[6] It was claimed that this was primarily a consequence of a number of unfinanced permanent reforms implemented by the previous Government. The Government's overall assessment, particularly in view of the economic situation, was that the deviation was so great that achieving net lending of 1 per cent during the present mandate period was not reasonable. This would require improvement of structural net lending amounting to SEK 74 billion during the mandate period. The Government emphasised that it was important not to hinder the return to full capacity utilisation, and that it would be inappropriate to implement the measures that would be needed in order to achieve net lending of 1 per cent in 2018 when the output gap was deemed to be closed. Instead, the return could be expected to take another year or so. The practical policy rule for fiscal policy which provided guidance in BP15 was that all reforms should be fully financed.

From what is stated in BP15, it would be possible to get the impression that cutbacks in structural net lending amounting to SEK

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[5] Press conference, 23 August 2014.

[6] "Surplus target will not be met. Now the deficits must be forced back step-by-step so that Sweden is no longer breaching the fiscal framework." (BP15, p. 27).

74 billion would be required in addition to the policy in the bill in order to achieve net lending of 1 per cent in 2018. However, this was not the case. According to the bill, structural net lending was automatically improved from -0.9 to 0.5 per cent of GDP between 2014 and 2018, which is equivalent to roughly SEK 50 to 55 billion. Active austerity measures did not help to bring about this improvement as the reforms proposed were fully financed throughout the entire period. Instead, the improvement in structural net lending came about from underlying factors, primarily the automatic improvement of the budget, due to the fact that when rules are left unchanged, income increases by approximately the GDP development while expenditure increases more slowly in the absence of active measures. "Krona for krona"[7] therefore involves improvement of net lending as the automatic austerity is permitted to act fully and is not counteracted by expansionary measures. The proposed policy involved improvement of structural net lending by SEK 50 to 55 billion during the mandate period, according to the Government's calculations. Thus what would have been needed to achieve a 1 per cent surplus in 2018, according to the calculations in BP15, was not measures amounting to SEK 74 billion, but rather SEK 20 to 25 billion, i.e. the difference between the cutbacks already included in the bill and the cutbacks that would have been required to achieve a 1 per cent surplus.

In October 2014, the Council criticised the Government for failing to comply with the fiscal framework. The Council referred to the Government's view that the economic situation would achieve equilibrium in 2017–2018, and considered it necessary to plan to achieve 1 per cent net lending at that time. In the opinion of the Council, postponing the return to 1 per cent net lending was not justified in respect of stabilisation policy. The Council also pointed out that the policy had previously been deemed to deviate from the surplus target and queried the previous Government's postponement of the return to a 1 per cent surplus.[8] The Council stands by its

[7] "Krona for krona" is used as a designation for a principle whereby all new proposals must be fully financed in every single year. However, this principle does not mean that expenditure increases or income weakening measures dependent on matters other than active policy need to be financed.
[8] Fiscal Policy Council (2014a).

assessment, that the plan presented in BP15 was not consistent with the surplus target.

However, since then the forecasts on economic development and development of central government finances have been revised. Our opinion of stabilisation policy is developed in section 2.4. The Council also has opinions on the structure of the surplus targets, and we will return to these in chapter 5.

2.2.2 The Riksdag's budget decisions

The Riksdag upheld the Alliance's budget motion at the poll held on 3 December 2014 and rejected the Government's budget bill. With this, the Riksdag agreed to the Alliance's proposals for guidelines for economic policy and budget policy, expenditure ceilings for the period 2015–2017, frameworks for expenditure areas, appropriations, income calculation and proposals in respect of tax legislation.

The adopted budget included lower levels for income, expenditure and expenditure ceilings than were specified in the bill, but the fundamental principle of fiscal policy austerity was the same as in the budget bill. All reforms should be fully financed. The motion proposal was based on the same underlying macroeconomic development and development of central government finances as BP15. However, both income and expenditure were lower in the Alliance's proposal than in the Government's. For 2015, the Government proposed increases in both income and expenditure amounting to approximately SEK 25 billion, while the corresponding Alliance measures amounted to approximately SEK 10 billion. Net lending – both actual and structural – was developed in more or less the same way in both alternatives.

The Alliance's motion and the reservation on the guidelines for economic policy upheld by the Riksdag express an ambition of achieving 1 per cent net lending when the economy is deemed to have achieved equilibrium, i.e. in 2018.[9] To be able to succeed in this, budget improvements amounting to approximately SEK 25 billion are needed in addition to the proposals in the motion, and these improvements should be implemented in 2017 and 2018, wrote the

[9] Bet. 2014/15:FiU1, reservation 1, pp. 123–127.

Riksdag. A number of budget improvement principles were presented, and a number of areas were pointed out. The principles, the areas pointed out and the extent of the budget improvements were essentially the same as those pointed out by the previous Minister of Finance.[10] No specific measures or calculations were presented. The motion did not make it clear whether the Alliance shared the Government's opinion that the surplus target had been breached, but as the proposals of the motion were of the opinion that active measures totalling SEK 25 billion in 2017 and 2018 were needed in order to meet the surplus target, it seems reasonable to assume that the opposition at least realised that there was deviation from the surplus target.

The Council has asked to be able to view the data for the calculations of the 25 billion so as to be able to assess whether the intended budget improvements are reasonable and realistic, but these requests have been rejected.[11] This means that it is not possible to determine how much substance there was behind the commitments in the motion, and hence in this part of the Riksdag's decision. The Council is of the opinion that this is clearly unsatisfactory, and it is doubtful whether the decision of the Riksdag can be considered to constitute a plan for returning to the surplus target.

The rejections of the Council's request also raise the more general issue of the Council's access to information to be able to do its job. Despite the fact that the Government's instruction to the Council states that the Council must review "the foundations for economic policy and the reasons for proposals for measures" and "review and assess the quality of forecasts submitted and the models which form the basis of these forecasts", the Council has no formal backing to be able to acquire the data required to do this.[12] The Swedish National Audit Office has formal backing for acquisition of the information it requests for its reviews,[13] but the Council has no such rules. We also note that in its guidelines for fiscal policy councils in member states, the OECD says that the Government must also ensure in the regulatory framework that fiscal policy councils are given access to all

[10] Government press conference, 23 August 2014.
[11] The Council has attempted to require this information from both the Government Offices and the Moderate Party's Riksdag secretariat.
[12] SFS 2011:446, section 7.
[13] SFS 2002:1022.

the information they consider necessary in order to do their job of reviewing fiscal policy.[14] We are of the opinion that the Council's formal opportunities to gain access to the information required by the task need to be reinforced.

2.2.3 The Spring Fiscal Policy Bill

In VP15, the Government repeats its opinion that there is clear deviation from the surplus target. Taking into account the high level of unemployment, the Government states – as in the budget bill – that it would not be appropriate to adopt a fiscal policy which returns net lending to a 1 per cent surplus within the mandate period. The Government's opinion is that achieving the target level of 1 per cent only during the next mandate period is justified.

Net lending is estimated to be weaker than in the budget bill, with a greater gap to the surplus target. Structural net lending in 2018 was estimated to amount to 0.5 per cent of GDP in BP15, and to -0.1 per cent of GDP in VP15. Thus the need for austerity to achieve 1 per cent net lending within the mandate period is deemed in VP15 to be just over half a per cent of GDP greater.[15]

As in the budget bill, the policy rule for fiscal policy is that all reforms must be financed fully and thus allow net lending to be improved gradually.

2.3 The expenditure ceiling

2.3.1 Decreasing expenditure ceiling

The expenditure ceiling sets an upper limit for central government expenditure. This ceiling includes all budgetary expenditure areas, except for Ea26 Government debt interest rates, and also expenditure for the old-age pension system alongside the central government budget. This adds up to the ceiling-limited expenditure,

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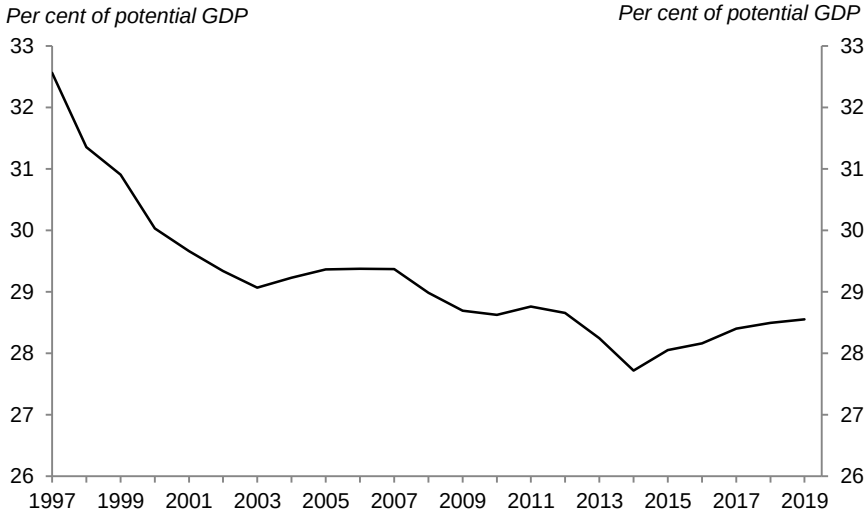
[14] OECD (2014d).

[15] From VP15, the Government applies a new method for calculating structural net lending. We have criticised the Government's calculations in a number of reports and advocated a disaggregated method, and we now note with satisfaction that the Government has changed its calculation method in line with the Council's suggestion. However, this change of method is of little significance to the forecast for structural net lending between 2015 and 2019 (Ministry of Finance 2015b).

as it is known. The difference between the ceiling-limited expenditure and the expenditure ceiling is constituted by the budgeting margin, which is a buffer designed primarily for use for dealing with forecast changes and uncertainties in the calculations. The part of the budgeting margin needed for dealing with uncertainties is normally known as the safety margin. The rest of the budgeting margin can be used for measures, provided that this is consistent with the surplus target.

The expenditure ceiling has gradually been reduced in relation to GDP since it was introduced. The expenditure ceiling amounted to almost 33 per cent of GDP in 1997 and had fallen to approximately 29 per cent by 2003 (Figure 2.1).

Figure 2.1 The expenditure ceiling 1997–2019



Source: VP15.

This reduction was part of the budgetary consolidation of the 1990s and took place when the target for public finances was to achieve equilibrium in 1998, and then to phase in the surplus target which came into force in 2000. However, the declining trend for the expenditure ceiling continued even after the consolidation period. The Reinfeldt Government declared in their first budget bill, BP07, that the ambition of the Government was to slightly reduce the

expenditure ceiling over the next few years as a percentage of GDP.[16] This ambition was maintained during the whole term of office of the Reinfeldt government. Admittedly, the expenditure ceiling increased as a percentage of GDP between 2008 and 2009, but this was because GDP for 2009 was considerably lower than had been estimated when the ceiling was set. Every time a decision was made, the expenditure ceiling was set so that it continued to decline as a percentage of GDP. The last time this was expressed was in VP14, when the expenditure ceiling was estimated to fall from 28.5 per cent to 27.5 per cent of GDP between 2014 and 2018. The budget decision made by the Riksdag in December on the basis of the Alliance's budget motion involved a continuation of this downward trend.

2.3.2 New principle for establishing the expenditure ceiling

The expenditure ceiling is not normally changed once it has been established by the Riksdag.[17] However, the level of the expenditure ceiling is an expression of the political direction, and so it is natural for different governments to have different views on what constitutes an appropriate level for the expenditure ceiling. It is also customary for the opposition to propose different expenditure ceiling levels to the Government in their budget alternatives to the Riksdag. The expenditure ceiling level was reduced by SEK 11 billion in the first budget bill of the Reinfeldt government as an indicator of the change in political direction. The Löfven government proposed in BP15, for its part, an increase in the expenditure ceilings for 2015–2018[18] and launched a new principle with regard to establishment of the ceiling, namely as a constant percentage of potential GDP. In

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[16] BP07, p. 109.

[17] The ceiling can be changed by means of what are known as technical corrections, but one distinctive feature of these is that they do not affect the austerity of the ceiling. Such an increase in the expenditure ceiling may, for example, involve municipalities losing tax revenues as a consequence of a change in the rules but receiving compensation from the State in the form of increased state subsidies. Technical adjustment of the expenditure ceiling then prevents any such expenditure increase taking up the scope for other expenditure.

[18] Informal terms, only increased expenditure ceilings for 2015 and 2016 were proposed. A ceiling was proposed for the first time for 2017, but this exceeded the assessment in VP14, and an assessment was carried out for 2018 which was also at a higher level than the assessment in VP14.

other words, the expenditure ceilings should follow the economy's trend growth. This means that government expenditure will develop approximately in line with public tax revenues if the rules remain unchanged. The proposed expenditure ceiling levels involved increases of the ceilings by SEK 33–68 billion between 2015 and 2018 (Table 2.1).

Table 2.1 Expenditure ceilings according to VP14 and BP15

SEK billions (per cent of potential GDP)	**2014**	**2015**	**2016**	**2017**	**2018**
VP14	1,107	1,127	1,167	1,214	1,254
	(28.5)	*(27.9)*	*(27.9)*	*(27.8)*	*(27.5)*
BP15	1,107	1,160	1,207	1,265	1,322
	(27.6)	*(28.0)*	*(28.0)*	*(28.0)*	*(28.0)*
Proposed increase in the expenditure ceiling	0	33	40	51	68

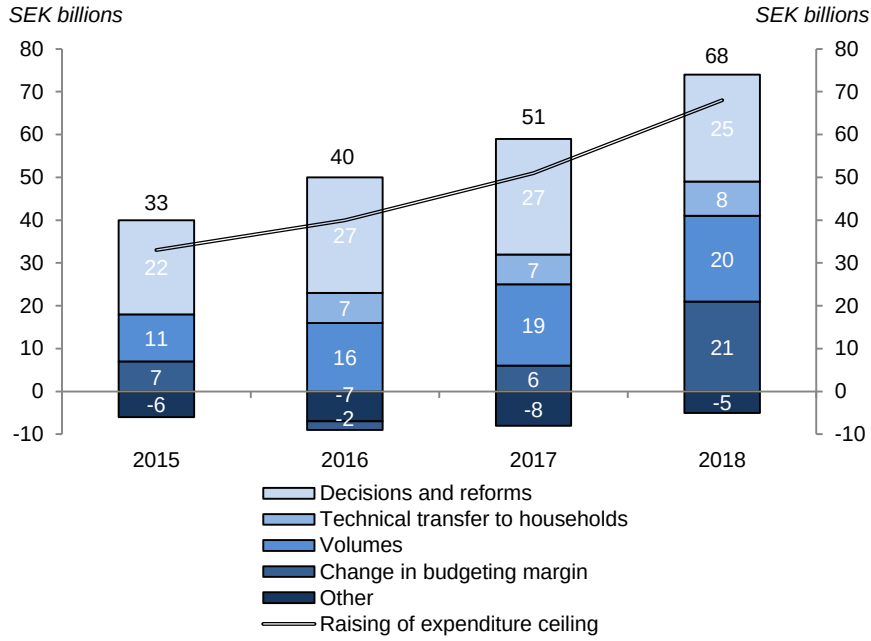
Sources: VP14 and BP15.

There were a number of reasons for the proposed increases in expenditure ceilings: firstly, with a view to creating scope for the reforms proposed by the Government. These reforms were also estimated to increase ceiling-limited expenditure by between SEK 22 billion and SEK 27 billion each year. Secondly, they created scope for what is known as the technical transfer exchange. The budget proposal was over financed by approximately SEK 7 billion per year from 2016, and the intention was to use the scope for increased expenditure not specified in the bill. Thirdly, increased expenditure ceilings were proposed in order to accommodate expenditure resulting from increased volumes, primarily as a consequence of more asylum seekers and new arrivals, but also for increased forecasts for sick pay and sickness benefits. Fourthly, the expenditure ceilings were counted down as a consequence of factors which were estimated to reduce expenditure. This included lower expenditure for the old-age pension system and lower productivity cuts for government authorities which helped to hold back the increase in the expenditure ceilings.

According to the principle, the expenditure ceilings were estimated to amount to 28 per cent of potential GDP, and therefore changes to expenditure ceilings were proposed beyond what was justified by the factors above. Expenditure ceilings of 28 per cent of

potential GDP mean that the budgeting margins – i.e. the gap between the estimated expenditure and the expenditure ceiling – will increase by SEK 6–7 billion in 2015 and 2017, but fall by SEK 2 billion in 2016 compared with VP14. In 2018, the budgeting margin is estimated to be SEK 21 billion higher than in VP14 (Figure 2.2).

Figure 2.2 Change in expenditure ceilings from VP14 to BP15



Source: BP15, Table 8.8, p. 423.

The Government's expenditure ceiling proposal involved significant expenditure scope, particularly towards the end of the mandate period. However, the Government intended to follow the principle of full financing of all reforms. In other words, the increased budgeting margins provided no scope for unfinanced reforms, but they did provide an opportunity to implement financed expenditure-increasing measures.

2.3.3 The Riksdag's decision on expenditure ceilings

However, the Riksdag did not back the Government's budget proposal but instead upheld the Alliance's budget motion including

its expenditure ceiling proposals, which were the same as in VP14.[19] Thus the decision of the Riksdag meant that the ceiling-limited expenditure was established at a considerably lower amount than in the Government's proposal (Table 2.2). Expenditure was more than SEK 16 billion lower in 2015, and expenditure in 2016–2018 was approximately SEK 26–29 billion lower than in BP15. This reduction in relation to the budget bill is due partly to the fact that in its proposal, the Alliance replaced the Government's expenditure increases with its own, less extensive increases, and partly to the fact that the additional scope reserved by the Government by means of what is known as a technical transfer exchange was rejected. As regards the development of expenditure alongside the active measures, the Alliance's motion was based on the same assessment as the budget bill. The expenditure increases due to factors other than reforms, primarily changed volumes and macroeconomic changes, thus made an impact on the motion and in the decision of the Riksdag. Expenditure in the adopted central government budget for 2015 was therefore lower than the Government's proposal, but higher than in VP14. As the expenditure ceilings were not adjusted, this in turn means that the budgeting margins were considerably smaller. The budgeting margins were roughly halved compared with the Alliance's calculations in VP14.

Table 2.2 Expenditure ceilings according to Riksdag decisions

SEK billions	**2015**	**2016**	**2017**	**2018**
Adopted and estimated expenditure ceilings	1,125	1,163	1,210	1,250
Expenditure subject to the ceiling	1,117	1,145	1,186	1,218
Budgeting margin	8	18	24	32

Source: Motion 2014/15:3002.

[19] Compared with VP14, the set expenditure ceilings are SEK 2 billion lower in 2015 and SEK 4 billion lower in 2016–2017. The ceiling for 2018, which is merely an estimate, is also SEK 4 billion lower than in VP14. This reduction is not justified in the motion, but it is probably due to a technical adjustment as a consequence of the proposal for gradual abolition of deductions for private pension savings.

2.3.4 Government expenditure ceiling proposal, spring 2015

In VÄB15, the Government returned with proposals for increased expenditure ceilings which involved a return to what was proposed in BP15 (Table 2.3).[20] The expenditure ceiling proposed, as in BP15, amounted to approximately 28 per cent of potential GDP. The proposals for reforms in the change budget were less extensive than in BP15, and so the budgeting margins were greater. The Government also returned with what is known as the technical transfer exchange, which means that there is a certain degree of financed scope for measures. The technical transfer exchange amounts to approximately SEK 3 billion per year for 2017 and 2018, and SEK 5 billion for 2019.

Table 2.3 Expenditure according to VP15

SEK billions	**2015**	**2016**	**2017**	**2018**	**2019**
Adopted and estimated expenditure ceilings	1,158	1,204	1,262	1,319	1,378
Expenditure subject to the ceiling	1,117	1,166	1,213	1,249	1,274
Budgeting margin	41	38	49	70	104

Source: VP15, Table 7.2, p. 131.

The increased expenditure ceilings give gradually increasing budgeting margins. The margin amounts to just over 8 per cent of the ceiling-limited expenditure for 2019, which means significant scope for higher expenditure. Measures must be financed fully, but how long this principle will apply is not clear.[21] Expenditure which increases for reasons other than measures, e.g. rising volumes, is not covered by the principle of full finance but is largely accommodated under the expenditure ceiling. The level of the expenditure ceiling is an indicator of the political will for expenditure development different to the previous government. We have no opinions on this, but we are of the view that there is a risk that the large budgeting margins will weaken the steering role of the expenditure ceiling so that the ceiling does not provide sufficient support for gradual improvement of government net lending.

[20] The expenditure ceilings were not exactly the same as in BP15 on account of technical adjustments.
[21] In VP15 (p. 97), the Government writes that it is also intending to apply the principle in BP16. However, there is no undertaking extending further than that.

2.3.5 The need for safety margins

There are establish guidelines on the size of margins needed in order to deal with uncertainties in the calculations so that the expenditure ceiling does not need to be adjusted as a consequence of normal variations in expenditure.[22] This scope is known as the safety margin, and it is part of the budgeting margin but does not provide scope which can be used for active measures. The expenditure ceilings established by the Riksdag in December 2014 mean that there was no scope beyond this safety margin. The margin for 2015 was smaller than the safety margin, i.e. the scope for measures was negative. The established expenditure ceilings thus provided no scope for expenditure-increasing measures, even if these were financed, and options for dealing with expenditure increases due to volumes or macroeconomic changes were very limited.

Under the Budget Act, the Government is obliged to take action if it feels that the expenditure ceiling is under threat.[23] In its 2014 report, the Council wrote that the scope beneath the 2015 expenditure ceiling available for use for active measures was non-existent, and stressed that it was important to avoid situations in which short-term measures were forced through in order to comply with the expenditure ceiling.[24] Such measures risk having an adverse effect on central government effectiveness and governance and also run counter to the ambition to provide the authorities with stable planning conditions. Therefore, the Council considered it important to maintain sufficient margins under the expenditure ceiling. The central government budget for 2015 and the established ceilings for 2016–2018 failed to achieve this.

The Government proposed in VÄB15 that the expenditure ceilings should be changed back to the levels proposed in the budget bill. The lower expenditure ceiling levels established by the Riksdag in 2014 will therefore be of no practical significance. Rather, there is a risk that the budgeting margins are now so great that the role of the expenditure ceiling is being weakened.

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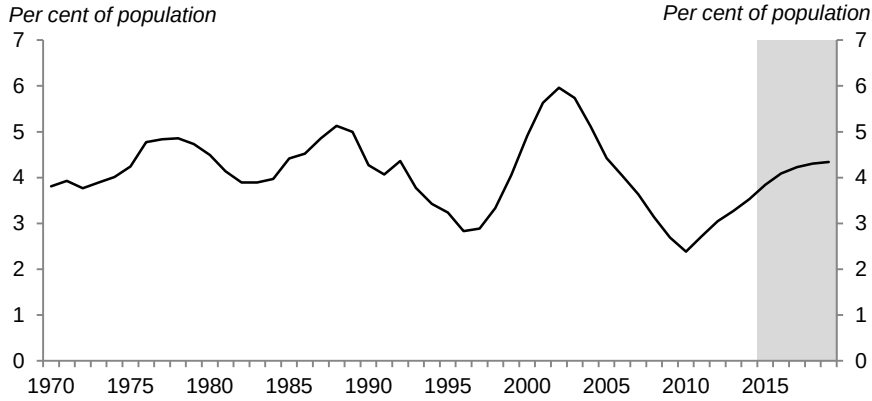
[22] The guidelines, expressed as percentages of ceiling-limited expenditure are: current year 1 per cent; year (t+1) 1.5 per cent; (t+2) 2 per cent; (t+3) and (t+4) 3 per cent. These guidelines have not been formally established and are not binding. They have, however, been used for a long time.
[23] SFS 2011:203, Chap. 2, section 4.
[24] Fiscal Policy Council (2014b), p. 154.

2.3.6 Expenditure risks

The expenditure ratio has been on a downward trend since the mid-1990s as a consequence of factors such as declining sick leave and changes to the rules in the transfer systems. In its 2014 report, the Council stated that the decline in the expenditure ratio would not necessarily continue. The Council noted, among other things, that sickness benefit has been underestimated for the past few years and demonstrated in a rough estimate that expenditure on sickness benefit could be significantly higher than was estimated in BP14.[25]

The forecasts for both sick leave and migration have been revised upwards on a number of occasions since then. Sick leave, which was on a downward trend after 2002 and at a historically low level in 2010, has begun to increase again over the past few years (Figure 2.3). The number of psychiatric diagnoses, but longer periods of sick leave in general, have increased in particular over the past few years.

Figure 2.3 Percentage of the population on sickness and rehabilitation benefits

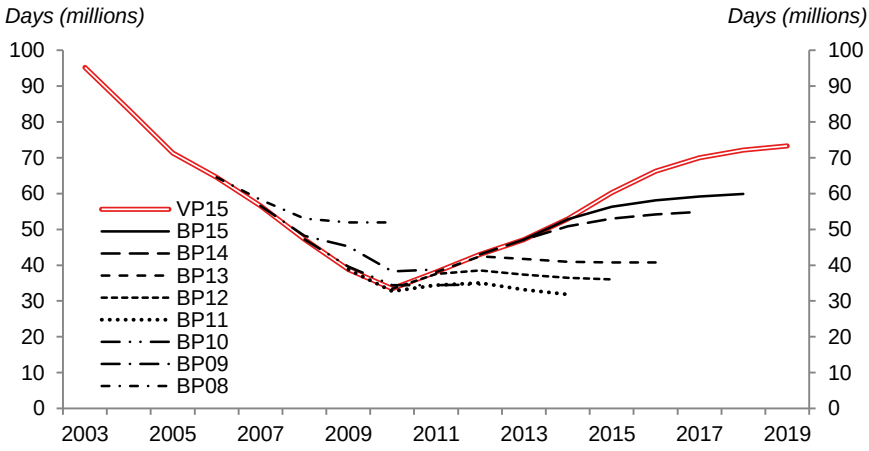


Note: Numbers of people are measured as full-year equivalents, i.e. two people who are each on sick leave for six months are counted as one full-year equivalent. Indicated as a percentage of the population aged 20–64. Including sick pay paid by the employer. The years 2015-2019 are a forecast.
Source: VP15.

[25] Fiscal Policy Council (2014b), pp. 39–44. See also Fiscal Policy Council (2013), pp. 79–83.

The forecast for the number of sickness and rehabilitation benefit days was revised upwards again in VP15 with reference to increased influx of new cases of sickness and longer duration of sicknesses (Figure 2.4).

Figure 2.4 Forecasts for the number of sickness benefit and rehabilitation benefit days



Sources: BP08–VP15.

The population increased by more than 100,000 people in 2014, of which immigration (net) accounted for approximately 76,000 people. The number of asylum seekers from Syria has increased enormously over the past few years. Since February 2014, the Migration Authority has revised its forecast interval for new asylum seekers upwards in 2015, from 47,000–67,000 to 80,000–105,000 people (Table 2.4).

Table 2.4 The Migration Authority's forecast for new asylum seekers

Thousands (interval)	**2015**	**2016**	**2017**	**2018**	**2019**
Forecast (February 2015)	80–105	70–105	48–87	45–87	42–87
Forecast (February 2014)	47–67	45–67	41–67	38–67	

Sources: Migration Authority (2014) and (2015).

The expenditure forecasts have also been increased as a consequence (Table 2.5). Expenditure for migration is estimated to peak in 2015–2016 and then decline, while expenditure for integration and sick leave will continue to increase throughout the entire forecast period.

Table 2.5 Appropriation forecasts for sickness benefit, migration and integration

SEK billions	2015	2016	2017	2018	2019
Sickness benefit and rehabilitation					
Social Insurance Office (February 2015)		41.4	43.9	45.8	46.9
BP15	34.9	36.9	38.0	39.1	
BP14	32.6	34.1	34.9		
Migration					
Migration Authority (February 2015)	17.9	20.0	17.2	14.2	12.7
BP15	17.4	17.7	15.8	14.4	
BP14	9.5	9.4	9.5		
Integration					
BP15	16.8	20.9	25.0	25.0	
BP14	13.5	14.4	14.4		
Of which municipal remuneration for refugee receptions:					
Migration Authority (February 2015)	9.1	12.4	17.4	20.6	20.3
BP15	9.5	11.8	14.6	15.4	
BP14	8.0	8.3	8.5		

Note: Refers to Ea10 (appropriation 1:1), Ea8 and Ea13 (appropriation 1:2).
Sources: Social Insurance Office (2015), Migration Authority (2015) and BP14–BP15.

In VP15, the ceiling-limited expenditure is revised upwards by between SEK 24 billion and SEK 34 billion for 2016–2018 compared with the budget adopted for 2015 (Table 2.6). A large proportion of the expenditure increases are due to the increased volumes in respect of transfer systems, including asylum seekers, people undergoing establishment, people with study funding and people with sickness benefit and sick pay. Expenditure is estimated to be approximately SEK 22 billion higher in 2018 as a consequence of the volume changes, which is equivalent to almost 0.5 per cent of GDP. VÄB15 also proposes an increase in the sickness benefit appropriation of SEK 2.5 billion for the present year as a consequence of the increase in the number of cases of sickness.

Table 2.6 Change in expenditure subject to the ceiling in VP15 compared with the budget adopted for 2015

SEK billions	**2016**	**2017**	**2018**
Change in expenditure subject to the ceiling	23.5	29.8	34.3
Of which volume changes	*10.9*	*16.8*	*21.8*

Source: VP15, p. 140.

There is major uncertainty in the forecasts and hence a significant risk of the expenditure developing in a manner other than as forecast. The effect of the volume changes in the transfer systems on public finances is also major. It is important for fiscal policy to be able to cope with these unforeseen expenditure increases with regard to both the expenditure ceiling and the surplus target.

2.4 Stabilisation policy

In the 2014 report, the Council was of the opinion that there was a risk of the fiscal policy becoming too expansionary. The reports in BP14 provided plenty of scope for variations in the stabilisation policy. In VP14, the Government was clearer when stating that all reforms would need to be financed fully, but at the same time the time for achieving 1 per cent net lending was postponed by a year, although the development of the economic situation indicated not a more prolonged period of recession, but that economic development was stronger than was deemed previously to be the case.

In BP15, the Government estimated structural net lending for 2014 to amount to -0.9 per cent of GDP, just under 2 percentage points beneath the target level of 1 per cent. Calculations of the output gap indicated at the same time that the economic situation was forecast to be in equilibrium in 2018. Return to net lending of 1 per cent in the event of an economic situation in equilibrium would therefore have required improvement of structural net lending by approximately 2 per cent of GDP, equivalent to approximately SEK 75 billion, over a period of four years. The Government's assessment was that such improvement of structural net lending would impede the return to full employment and that it was therefore not appropriate to aim to achieve 1 per cent net lending by 2018.

The Council did not find the Government's argument to be convincing. Tightening up fiscal policy during an economic upturn is

part of normal stabilisation policy. Active economic policy involves counteracting economic downturns by means of expansionary policy and slowing economic upturns by means of contractionary policy. The ability to recover a deficit which has occurred during an economic downturn once the economic situation returns to normal is a central prerequisite for active stabilisation policy to be possible at all. A contractionary fiscal policy during economic upturns always means that development is weaker than it would have been without a contractionary policy. A certain slowdown of economic activity during prosperous times is a price which has to be paid to allow stabilisation policy to alleviate economic downturns by means of an expansionary policy. Therefore, the fact that the return to the surplus target is slowing economic recovery is not, in itself, a sufficient argument for refraining from attempting to achieve the surplus target.

Would an unreasonably fast austerity rate have been required in order to anticipate achievement of a 1 per cent surplus in 2018 in BP15? The necessary improvement of structural net lending was estimated to stand at approximately 2 per cent of GDP for four years, i.e. approximately 0.5 per cent of GDP per year. Such improvement cannot be regarded as alarmingly fast. Instead, it is reasonable that an ambitious stabilisation policy will often involve a need for improvements at such a pace. The improvement of structural net lending is very much in line with both the pace constituting a guideline in the EU's budget rules and rules of thumb used by the International Monetary Fund (IMF). With these benchmarks, structural improvement of 2 per cent over four years does not appear to be unreasonable.

Box 2.1 What is a normal economic situation, and what is normal net lending improvement?

The fiscal framework allows for deviation from the target for government net lending if there are special reasons for doing so. Here, we would like to describe what demands could conceivably be specified with regard to how quickly a deviation from the government net lending target normally needs to be recovered. The figures are not to be viewed as precise; instead, the discussion is intended to be viewed as a starting point for assessment of normal orders of magnitude. It may be important to make rough estimates in order to avoid the risk of always arguing that the economic situation is exceptional and therefore justifies deviations from the framework.

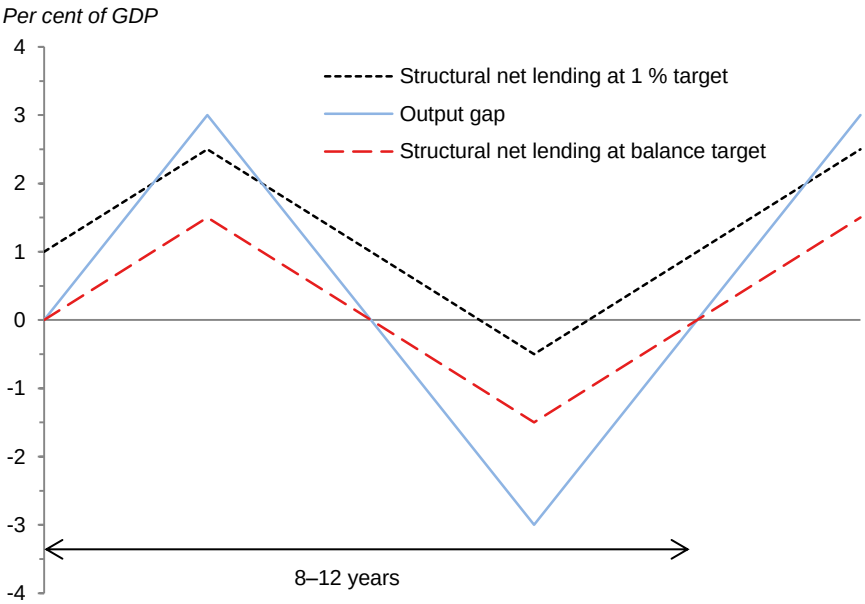
The EU and IMF also make simple estimates of what can be considered normal budget improvement. Both are of the opinion that improvement of structural net lending by 0.5 per cent of GDP per year during a period of economic recovery does not normally involve conflict with stabilisation policy. We share this opinion.

The idea behind stabilisation policy is to allow government net lending to vary in line with the development of the economic situation. Allowing net lending to be lower during economic downturns and higher during economic upturns counteracts variations in production, employment and unemployment. This leads to more stable economic development, which is good for the economy. Automatic variations in government net lending arise in that many items of government expenditure are either independent of the economic situation or increase when the economic situation is weakened, while at the same time government revenues covary positively with the economic situation. Besides these automatic stabilisers, as they are known, the Government and Riksdag may also pursue an active (discretionary) stabilisation policy, i.e. make decisions on increased expenditure or reduced taxes during economic downturns and the opposite during economic upturns.

The effect of the automatic stabilisers is that net lending changes by, on average, half a per cent of GDP for each percentage point change in the output gap. The Council has previously argued that the discretionary policy should not be stronger than the automatic policy. This means that cyclically adjusted net lending, which eliminates the effect of the automatic stabilisers, should normally be capable of

being changed by between 0 and 0.5 per cent of GDP for each percentage point change in the output gap.

Figure 2.5 Outline diagram showing structural net lending with different targets



How large is a normal variation in the economy, and how long is a normal economic cycle? There is no exact answer to this question, of course, but it is possible to make an estimate on the basis of the standard deviation in the output gap. According to NIER's calculations for the period 1980–2015, the standard deviation amounted to 2.7 per cent and the output gap deviated from zero by 1.7 per cent on average. On the basis of this, we estimate that the depth in a normal economic downturn is in the order of 3 per cent. As regard the length of an economic upturn, we work on the basis of a standard definition which indicates that economic situations are fluctuations with an approximate wavelength (peak to peak) of 8 to 12 years. The time from the cyclical trough until the output gap is zero once again is thus normally 2 to 3 years (Figure 2.5).

From this reasoning, it is evident that during normal cyclical development, the output gap is -3 per cent at its lowest and returns to zero over a period of 2 to 3 years. Government net lending, according to the reasoning above, can be expected to decline by

approximately 1.5 per cent of GDP when the economic situation reaches a normal trough as a result of the automatic stabilisers. In this case, structural net lending is between 0 and 1.5 per cent below normal. We therefore have to expect that under normal circumstances, improvements of structural net lending of up to 1.5 per cent of GDP may be required over a period of 2 to 3 years.

This means that a normal stabilisation policy will often require structural net lending to be improved by approximately 0.5 per cent of GDP per year. This applies irrespective of what target level applies for government net lending. In the opinion of the Council, such improvement is entirely reasonable. If, instead, it is thought that a improvement of 0.5 per cent per year is unreasonably contractionary, the conclusion is that fiscal policy must be less ambitious during economic downturns and primarily take place without a discretionary policy.

To conclude, we can state that the "krona for krona" principle is normally thought to provide improvement of government net lending by just under 0.5 per cent per year.[26] This primarily takes place by means of the fact that a number of transfers to households and municipalities do not follow GDP development. This improvement is of the same order as the 0.5 per cent that will be needed during normal cyclical variations. However, the "krona for krona" principle will not suffice in a situation in which unforeseen costs arise or when economic downturns are counteracted by active measures. An ambitious stabilisation policy during economic downturns will normally also require active savings measures during an economic upturn.

The opinion of the Council last autumn was that the surplus target was within reach and that the Government ought to have aimed to achieve the target. We are still of the opinion this was a reasonable assessment. It is sometimes argued in the public debate that in practice, the surplus target was already obsolete last autumn and that the deviation from the target was so great that it was neither possible nor appropriate to attempt to return to the target. The Council does

[26] We have utilised the Swedish National Financial Management Authority's estimate of the automatic budget improvement; see the National Financial Management Authority (2013).

not share that opinion. In our view, the deviation from the surplus target last autumn was not so great that a return would have been impossible. A improvement in line with international guidelines would have been reasonably well suited to achieving 1 per cent net lending in 2018.

It is also worth noting that structural net lending was deemed to be improved by 0.5 percentage points for both 2014–2015 and 2017–2018, and by 0.4 percentage points for 2015–2016. However, structural net lending was deemed to be unchanged between 2016 and 2017. This uneven trajectory for the improvement of structural net lending is linked with the fact that a return to a surplus will only take place through automatic improvement of net lending, and not with the help of active measures.

The job of the Council involves evaluating fiscal policy in relation to the applicable budgetary targets, the surplus target and the expenditure ceiling. It is particularly important to review arguments for deviation from the target. The Riksdag's decision from 2007[27], stating that the target for government net lending should amount to 1 per cent on average over an economic cycle, will apply until the Riksdag has decided something else. We are not of the opinion that the stabilisation policy arguments in BP15 for refraining from returning to net lending of 1 per cent by 2018 were convincing.

However, the task of evaluating whether the policy is in line with the existing fiscal framework does not prevent discussion of the formulation of the framework as well. In Chapter 5, we develop our view of the surplus target and advocate lifting the pension system out of the target. We also discuss the Government's plans to reduce the surplus target for general government from 1 per cent to zero on average over the economic cycle.

The usual opinion is that the economy is currently undergoing a recovery phase and will achieve cyclical equilibrium over the next few years. The deficits in net lending should therefore decline in future. In the economic debate, a number of reasons have been presented as to why fiscal austerity should be postponed until a future date. One argument is that monetary policy cannot become much more expansionary, and that the entire stabilisation policy task therefore

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[27] Bet. 2006/07:FiU20.

falls to fiscal policy. Another argument is that low interest rates provide a golden opportunity for central government to borrow for investments. The arguments for a more expansionary fiscal policy are not convincing.

First of all, the fiscal policy is already clearly expansionary. The deficit in the public finances amounts to approximately 1.5 per cent of GDP. The situation as regards demand is uneven, and the export industry in particular has been affected by the recession. Domestic demand, on the other hand, has been held up, partly as a consequence of expansionary fiscal policy and low interest rates. Household consumption increased by 2.4 per cent in 2014. Unemployment remains high, but there is much to indicate that this is due primarily to structural problems in the labour market rather than a general shortage of demand. Therefore, there is a need for targeted measures aimed at structural problems on the labour market, rather than general stimulation of demand.

Secondly, the real interest rate level, not the nominal interest rate level, is crucial to economic returns on investments. Nominal interest rates are historically low, but even though real interest rates are low at present, they are not exceptionally low from a historical perspective. Even more important is the fact that there are significant shortcomings in the way in which public funds are channelled into investments. In Chapter 6, we point out that there seems to be a very weak link between the investments in roads and railways that are deemed to provide the greatest economic benefit, and those which have actually been implemented. Economic considerations appear to play an insignificant role in the choice of investment projects. We consider it important to improve the methods for prioritisation between infrastructure projects, particularly in view of the debate which is currently being held concerning the need to increase investments in infrastructure.

Thirdly, we wish to emphasise that according to the Government's own calculations, the economy is not particularly far from an economic situation in equilibrium. According to VP15, the output gap is estimated to stand at -1.4 per cent in 2015, and the gap is estimated to be approximately equal to zero in 2017. Thus the recession will soon be over, according to the Government's own assessments. NIER is expecting a smaller output gap than the Government, and the Riksbank, OECD and IMF are all of the

opinion that production is considerably closer to its potential level than the Government believes. If this is correct, the structural deficit in government finances is greater than the Government is expecting, while at the same time the arguments in favour of the need for stimulation are considerably weaker.

We described above the rule of thumb which indicates that a 0.5 percentage point improvement of structural net lending per year during an economic recovery should not normally be viewed as risky in terms of stabilisation policy. Structural net lending will improve by 0.4 percentage points between 2014 and 2015 according to VP15, which is not far off this rule of thumb. The Council states that if structural net lending were to continue to improve at this pace, net lending of 1 per cent would still be within reach during the present mandate period.

The Government's focus on the policy involves following the principle whereby all reforms must be fully financed. This means that the structural deficit will be reduced at the pace provided by automatic austerity, which is normally around 0.5 per cent of GDP per year. However, as a stabilisation strategy a principle of this kind has major shortcomings. The tightness of the policy is largely determined by circumstances beyond the control of the Government. If, for example, expenditure increases or tax revenues were to decline unexpectedly, for reasons not due to the economic situation, austerity would be weakened and active measures would be needed to maintain the original rate of austerity. The inflation rate also affects how austere a policy follows on from this principle. The lower the rate of inflation, the weaker the automatic budget improvement.

Structural net lending was improved by 1.4 per cent between 2014 and 2018 in BP15, but in VP15 the corresponding improvement stands at 0.8 per cent (Table 2.7). This slower pace of improvement is not a consequence of another policy, but largely follows on from increased expenditure which is not due to the economic situation, but to increased volumes.

Table 2.7 Financial and structural net lending in VP15

Percentage of GDP	2014	2015	2016	2017	2018	2019
Net lending	-1.9	-1.4	-0.7	-0.4	0.0	0.4
Structural net lending	-0.9	-0.5	-0.4	-0.3	-0.1	0.4

Source: VP15.

The principle whereby all measures have to be fully financed is consistent with both a fast and a slow austerity rate and therefore provides little guidance as regards the linking of the austerity rate with the economic situation. The "krona for krona" policy rule does not, therefore, involve a commitment for net lending to return to a certain level once the output gap is closed. For net lending to achieve the target level at a certain time, all structural budget weakening measures need to be financed, not just the ones which are dependent on active measures. In normal cases, "krona for krona" may suffice to resume fiscal expansion, but situations can and will occur in which this will not suffice.

A background report to this year's report discusses how the economic situation is affected by changes to government net lending (Box 2.2).[28] One important conclusion is that the susceptibility of the economy to such changes is not a constant, but is dependent on a number of circumstances. It is noted in particular that this susceptibility is great if (i) the economy is undergoing financial crisis, with a large number of households with limited borrowing, (ii) the exchange rate is fixed, and (iii) the central bank has exhausted its options for supporting economic recovery. Under such circumstances, fiscal austerity may have significant adverse consequences for economic recovery. If, on the other hand, the situation in respect of central government finances is unsustainable and increasing deficits risk leading to an increase in interest rates, austerity may even underpin an economic recovery.

Of these factors, only one is potentially of relevance to current Swedish fiscal policy. At present the Riksbank's key interest rate is at or at least close to the interest floor. In the opinion of the Riksbank, it will be possible to start normalising monetary policy towards the end of 2016. A certain degree of caution in respect of the recovery of government deficits is warranted for 2016.

However, we are of the opinion that fiscal policy for the period 2016–2018 should be more contractionary than that proposed in VP15. Improvement in structural net lending of 0.5 per cent of GDP per year ought not to slow economic development to any serious extent and would, as noted above, place the target of 1 per cent net

[28] Corsetti and Müller (2015).

lending within reach during the present mandate period. There are no convincing arguments relating to stabilisation policy for a slower recovery of the deficit.

Box 2.2 Fiscal multipliers – lessons learned from the financial crisis

The financial crisis has given rise to renewed interest among researchers as regards assessment of how changes to fiscal policy affect economic development. For a long time, empirical research involved using linear time series models to provide reliable estimates of how great *the* fiscal multiplier was, i.e. the extent to which GDP is changed by a certain given change in central government expenditure (or taxes). Later research was instead based on the fact that the effects of fiscal policy on the economic situation cannot always be assumed to be equally great. Above all, researchers have studied the effects of fiscal policy in the situations following on from the crisis, such as turmoil in central government finances, recession and zero interest rates, as well as under various exchange rate regimes.

In the background report "Fiscal Multipliers: Lessons from the Great Recession for Small Open Economies" (2015), Giancarlo Corsetti and Gernot J. Müller summarise some of the empirical research in the field. One consistent result is that the fiscal multipliers are probably fairly small during normal times, but greater during recessions and financial crises. The empirical results also support the notion that the multipliers are greater under fixed exchange rates, rather than under flexible exchange rates.

Corsetti and Müller then contrast these empirical results with what a stylised, new Keynesian model for a small, open economy has to say about fiscal multipliers under various economic conditions. Their model results support the empirical results, indicating that the multipliers are greater under fixed exchange rates, during recessions and during financial crises, but fairly small during flexible exchange rates and under normal conditions. They also find that the multipliers may be greater when monetary policy has exhausted its options and reached the interest floor (zero or slightly negative interest rate). Changes to fiscal policy do not then lead to counteracting changes to interest rates, which increases the effect of the fiscal policy. Corsetti and Müller also indicate how the interaction between an expansionary fiscal policy and turmoil in central government

finances, defined as rising risk premiums on government bonds, can reduce the multiplier and even reverse the sign of the multiplier. In the latter case, contractionary fiscal policy could even have expansionary effects on the economic situation.

On the basis of their analysis and previous results, Corsetti and Müller summarise a number of lessons learned regarding fiscal policy from a stabilisation policy perspective:

Does the previous opinion, that discretionary fiscal policy should only be pursued under exceptional conditions, still hold true?

Yes. The research of the last few years, such as the results achieved by Corsetti and Müller, indicates that fiscal policy can be an effective way of stabilising the economy in the event of major disruptions, provided that the central government finances are deemed to be sustainable in the long term. Therefore, it is reasonable to limit the use of active fiscal policy stabilisation measures to these situations. Under normal conditions, fiscal policy should be pursued in a manner which creates sufficient scope for manoeuvre in the event of crises.

The financial crisis has made it clear that there are close links between financial vulnerability and the vulnerability of central government finances for countries. What are the implications of this for the formulation of fiscal policy?

The analysis carried out by Corsetti and Müller indicates how turmoil in central government finances which spreads to instability in the financial system can have a major impact on fiscal multipliers and thus massively restrict options for a stabilisation policy by fiscal means. Conversely, financial vulnerability can also have an adverse impact on the stability of central government finances, as indicated by developments in Ireland and Spain, for example. These risks of vicious circles, whereby financial and fiscal policy instability amplify one another, reinforce arguments in favour of fiscal policy being pursued on the basis of rigorous application of healthy principles.

2.5 The December Agreement

In the 2014 report, the Council expressed concern about the fact that the Riksdag's handling of BP14 involved weakening what is known as the framework model for budget decisions. Our opinion was that there was an obvious risk of the framework model for budget decisions being watered down and becoming less clear and less strict. We considered it very important that the political parties should unite on the forms for handling the budget in the Riksdag and that the framework model should be strong enough to function even in a complicated parliamentary situation.

The background to this was the fact that in the autumn of 2013, the Riksdag decided to raise the threshold for state tax as part of the framework decision. After that, the Riksdag made another decision – at the initiative of the Parliamentary Committee on Finance – which meant that the raising of the threshold was withdrawn. There are various opinions on whether this was in accordance with the Riksdag Act's rules on the framework model for budget decisions, and the issue was finally settled by the Committee on the Constitution. The Committee on the Constitution was of the opinion that what had happened was not in contravention of the Riksdag Act, but the Committee was not unanimous on this. The interpretation of the governing parties differed from that of the Committee on the Constitution. The broad political consensus on the rules for budget decisions was thus broken and the Council expressed concern about the breaking of this consensus and also about the fact that the prospects of minority governments pushing through their economic policies had worsened.

Given the Parliamentary situation in the autumn of 2014, and with an announced snap election to be called on 22 March 2015, all parliamentary parties except for the Left Party and the Sweden Democrats concluded an agreement on 26 December 2014 which aimed to strengthen the position of minority governments, known as the December Agreement. The core elements of the agreement are that the Prime Minister candidate who has the support of the largest possible configuration of parties will be let through and that a minority government will be able to get its budget through. The Council makes no comment on either the forms of premiership election or how the parliamentary parties act during budgetary votes

in the Riksdag. That said, we will comment on the elements of the agreement which are closely linked with the discussions on the budget process in the autumn of 2013.

The agreement means that the Riksdag's committee must not take the initiative for legislation or amending budgets which affect the adopted budget. In other words, the parties undertake to refrain from initiatives similar to that implemented by the Committee on Finance in the autumn of 2013. This eliminates the weakening of the budget process which took place at that time and was criticised by the Council.

The agreement also means that legislative proposals linked to the budget must be passed through the Riksdag so that there are no contradictions between the revenues estimated in the budget and the revenues resulting from the adopted tax legislation. Previously, there were also informal agreements in the Riksdag not to create such contradictions in instances in which the legislative proposals are not included in the budget bill itself. In practice, the wording in the agreement means that the previously informal agreements will continue to apply.

When the appropriations are to be decided upon by the Riksdag, the specialised committees are entitled to redistribute resources between appropriations within an expenditure area or to refrain from fully utilising an expenditure frame established by the Riksdag. The agreement means that the specialised committees will refrain from exercising this option and undertake not to amend the appropriation distribution proposed by the Government.

As regards committee initiatives and the handling of revenue calculations and tax legislation, the December Agreement may be interpreted as a return to earlier practice, which the Committee welcomes. The undertaking by the specialised committees not to amend the appropriation distribution involves a restriction compared with current practice. However, the specialised committees' option of redistributing the appropriations within their expenditure areas has been used very sparingly, so the practical significance of the new restriction will probably be limited.

The December Agreement means that minority governments have considerably greater chances of getting their budgets through the Riksdag. However, for decisions other than budget decisions, the risk of any minority government losing Riksdag votes is no less than it

was before. Thus the rules place minority governments in a strong position in respect of budget issues but provide no additional support for other issues, and so whether an issue is regarded as a budget issue is of crucial significance. This in itself is nothing new. Minority governments were also supported previously by a special decision-making procedure for budget issues, and there were greater chances of getting such issues through the Riksdag than was the case for proposals in other bills. However, the December Agreement means that this difference between decision-making processes is amplified as it more or less guarantees that the entire budget proposal of a minority government will be approved by the Riksdag with no changes.

The December Agreement led to the snap election announced been called off, and a provisional decision-making procedure was established.[29] However, there are a number of reasons for a certain degree of scepticism as to whether the agreement is stable enough to remain in place until the election in 2022. Firstly, the agreement has a weak formal position and the individual members of the Riksdag are under no obligation to follow it. Secondly, defining what ought to be classified as budget issues may be problematic and cause political tensions. Thirdly, there is political criticism of the legitimacy of the agreement and its political consequences.

The Council is of the opinion that it is important to have a strict and clear budget process which gives minority governments plenty of opportunities to get their budgets through and pursue a coherent economic policy. Therefore, it is important for the budget rules to be stable and have broad political support. The Council is in favour of the December Agreement contributing to an orderly budget process and providing support for minority governments. However, as the agreement has a weak formal position and may prove fragile, it will probably not suffice to provide sufficient stability for the budget process. Therefore, it is very important for the investigation to review the budget process as indicated in the agreement to take place, and for this investigation to find sustainable solutions to the issues which the December Agreement is aiming to overcome during a transitional period.

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[29] The agreement will remain in force until the election in 2022.

2.6 Assessments and recommendations

Last autumn, the Council was of the opinion that the Government's plan in BP15, not to achieve net lending of 1 per cent in 2018 even if the output gap were closed by then, was in breach of the surplus target. The Government's justification, that it would be irresponsible in terms of stabilisation policy to reinforce the budget by approximately 0.5 per cent of GDP when the economy has returned to equilibrium, was not convincing in the opinion of the Council. This assessment remains.

In the opinion of the Council, the fiscal framework requires financial policy to focus on achieving the target for net lending when the output gap is closed, unless there are compelling reasons – in respect of stabilisation policy, for example – to the contrary. The undertaking for all reforms to be funded is not sufficient to meet this requirement. To be able to focus on a certain level of net lending once the output gap is closed, and hence meet the surplus target, lasting budget weakening measures are also required which are dependent on the financing of matters other than active measures. We is of the opinion that the undertaking for all reforms to be funded is not sufficient to meet the requirements of the framework.

Fiscal policy should now focus on correcting the significant deficits which arose during the years of economic downturn. It is always tempting to refrain from necessary budgetary reinforcements 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.

NIER is of the opinion that the output gap will be closed in 2016. Achieving 1 per cent net lending from that time would require an improvement in structural net lending of 2 per cent of GDP between 2015 and 2016. In our opinion, such a rapid rate of consolidation would not be reasonable. Therefore, we deem the fiscal stance for 2015 and 2016 to be a deviation from the surplus target, but not a breach.

The improvement in net lending will come to a halt for the 2016–2018 period according to both NIER's forecasts and the Government's plans. For this period, the Government estimates that actual net lending will improve by a total of 0.7 per cent of GDP and structural net lending will improve by 0.3 per cent of GDP, so net

lending will be close to achieving equilibrium in 2018. Although the economic gap is estimated to be closed and the 1 per cent target has not been reached, improvement is very slow. In the opinion of the Council, this is not in line with a surplus target of 1 per cent and so it must be regarded as a breach of the fiscal framework.

It is not the Council's job to prescribe precisely the rate at which the deviation from the surplus target is to be recovered. Continuation at the pace estimated for the period 2014–2015, i.e. improvement of approximately 0.5 percentage points per annum, would however 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 being on a par with the surplus target during the present mandate period.

It is important to have a strict and clear budget process which gives minority governments plenty of opportunities to get their economic policies through. The budget rules need to be stable and have broad political support. We are in favour of the December Agreement contributing to an orderly budget process and providing support for minority governments. However, the agreement may prove fragile. Therefore, it is very important for the investigation indicated in the agreement to find long-term solutions to these issues.

We are of the opinion that the Council's formal opportunities to gain access to the information required by the task should be reinforced. According to its instruction, the Council must review "the foundations for economic policy and the reasons for proposals for measures" and "review and assess the quality of forecasts submitted and the models which form the basis of these forecasts", but it has no formal backing to be able to acquire the data required to do this. The Swedish National Audit Office has stronger formal backing for acquiring information, and the OECD recommends in its guidelines for fiscal policy councils that governments must also ensure formally that the council is given access to all the information they consider necessary in order to do their job of reviewing fiscal policy.

3 The labour market

One of the jobs of the Council is to assess whether the economic policy is leading to lasting high employment. In this chapter, we will initially study how the labour market has developed on the basis of a number of different dimensions such as labour force participation, rate of employment and unemployment. After this, the Council will discuss the formulation of the target for unemployment set by the Government and the prospects of achieving this target through increased employment. We will base this on the current situation in respect of the problem of unemployment, and also on the measures presented by the Government to date. Conflicts between what will probably be required in order to achieve an ambitious target for unemployment and other targets for economic policy are illustrated and discussed.

3.1 Good development of labour force and employment

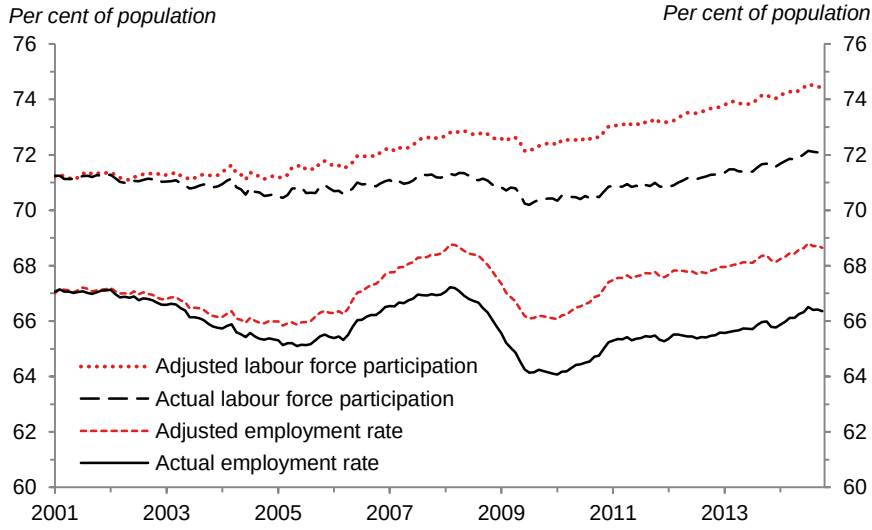
Development on the Swedish labour market appears to be good in a number of respects. Labour force participation – that is to say, the percentage of the population of working age available to the labour market – is high. 2014 saw the highest level since the early 2000s (Figure 3.1), although labour force participation fell in connection with the financial crisis. A drop in labour force participation during economic downturns is a normal cyclical pattern, but it risks having a lasting effect if individuals are permanently removed from the labour market. However, in 2013 labour force participation returned to the same level as before the crisis, and it continued to increase further in 2014. High labour force participation is a prerequisite for a high level of employment. In the long term, it is reasonable to assume that the level of employment will largely be determined by labour force participation.[1]

How labour force participation for the population as a whole develops is dependent on factors such as demographic changes. Over the last decade, above all the proportion of people aged 65–74 in the

[1] SOU 2011:11 and Forslund (2015).

population has increased. This has helped to slow the increase in labour force participation as older people generally participate in the labour force to a lesser extent than younger people. If labour force participation is corrected for demographic changes, therefore, the development is even more positive (Figure 3.1). Since 2001, age-adjusted labour force participation has increased from just over 71 per cent of the population to just over 74 per cent.

Figure 3.1 Actual and age-adjusted labour force participation and employment rate (age 15–74)

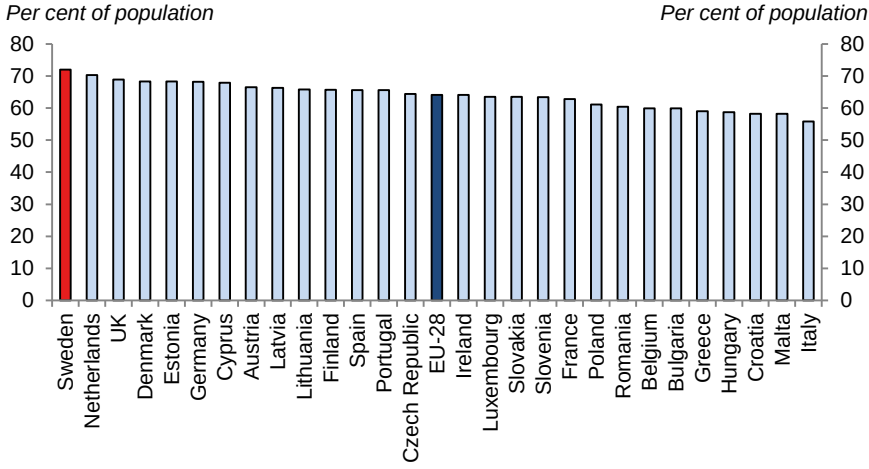


Note: Seasonally adjusted, three-month moving averages. The age composition of the population is held constant at the 2001 level (January) and employment and the labour force are projected in each age group (15–19, 20–24, 25–34, 35–44, 45–54, 55–64 and 65–74) with the help of the actual employment rate and actual labour force participation for each age group. The adjusted employment rate and the adjusted labour force participation therefore show developments adjusted for demographic changes in the population.
Sources: Statistics Sweden (2015a) and own calculations.

Employment has also developed relatively favourably over the past few years. Employment is usually measured as the rate of employment, i.e. the proportion of employed people in the working-age population. The rate of employment fell enormously during the financial crisis – to 64 per cent at its lowest level – but it has risen again since then and amounted to 66 per cent at the end of 2014. However, this was still lower than before the financial crisis.

However, the development of employment is also more positive when we control for demographic changes. Adjusted for changes in age composition, the rate of employment at the end of 2014 stood at approximately the same level as before the financial crisis. Given the fact that capacity utilisation in the economy is deemed to have been high in the years before the crisis, while an economic downturn still prevailed in 2014, this must be regarded as an unexpectedly favourable development in employment.[2]

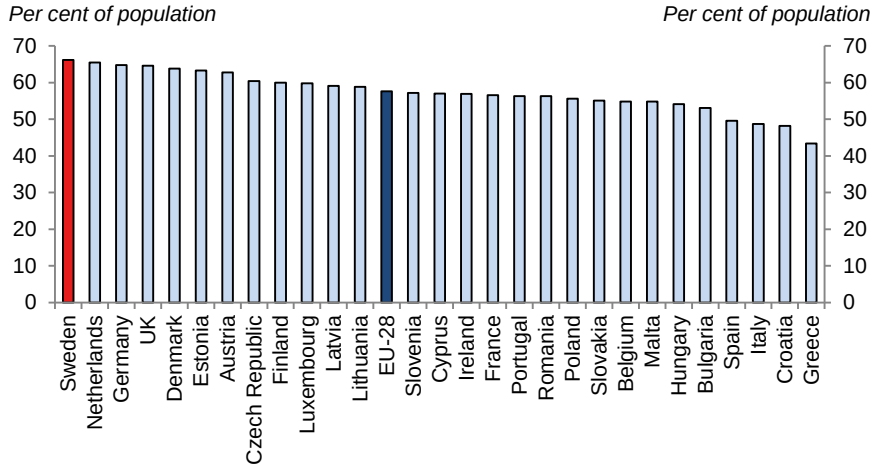
Figure 3.2 Labour force participation in the EU, 2014



Note: Refers to the 15–74 age group.
Source: Eurostat (2015).

[2] Both the Government (VP15) and the National Institute of Economic Research (2015c) make this assessment of economic development; see Chapter 1.

Figure 3.3 Employment rate in the EU, 2014



Note: Refers to the 15–74 age group.
Source: Eurostat (2015).

Both labour force participation and the employment rate are high from a European perspective as well. In 2014, Sweden had both the highest labour force participation and the highest employment rate in the EU (Figures 3.2 and 3.3 above).

Figure 3.3 also shows that a number of other countries – the Netherlands, Germany, the United Kingdom and Denmark – have employment rates close to the Swedish level.

We compare the rate of employment for different age groups and genders below in order to gain a better understanding of what explains the differences in employment rates between different countries. We will limit this comparison to other Nordic countries, Germany and an average of all EU countries.[3]

We exclude the youngest age group, people aged 15–19, from the comparison. International comparisons of employment rates among young people of upper secondary age are complicated by differences in education systems and other factors.[4]

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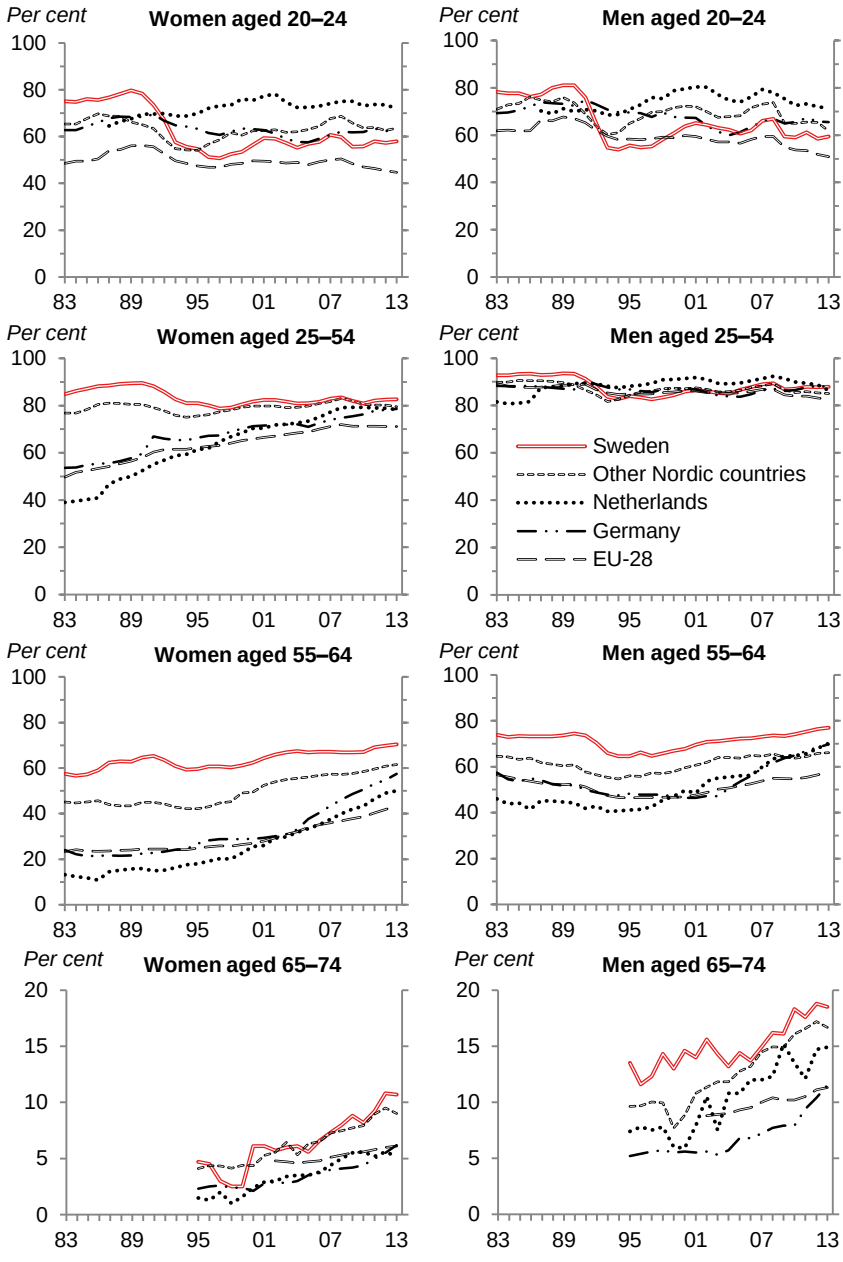
[3] For more detailed comparison of the labour market in Sweden and other countries in these and other dimensions, see Malmberg and Öberg (2014).

[4] In Denmark and Germany, for example, anyone who does an apprenticeship at upper secondary school receives pay while they are studying, and these people are therefore deemed to be employed. See Fiscal Policy Council (2014b), section 3.4, for a more detailed discussion of problems with international comparisons of the labour market for young people.

Figure 3.4 shows that Sweden has a comparatively high rate of employment among women aged 25–54 and older people (people in the 55–64 and 65–74 age groups). The high employment rate among older people is applicable to both men and women. It is notable that employment among older people, primarily in the 55–64 age group and among men in the 65–74 age group, has been higher than in the comparison countries for a number of decades, but even so – despite the good starting point – Swedish employment has increased over the past few years in these groups in particular.

Figure 3.4 Employment rates among men and women in the EU, by age group, 1983–2013



Note: "Other Nordic countries" refers to an average for Denmark, Finland and Norway. No data is available for the 65–74 age group before 1995.
Source: OECD (2015b).

The rate of employment among men in the 25–54 age group is only marginally higher than in other countries. Overall, there is very little variation in employment rates for men in this age group, both between countries and over time.

Unlike other age groups, the rate of employment among people aged 20–24 is lower in Sweden than in neighbouring countries. Admittedly, it is higher than the EU average, but lower than in other Nordic countries, Germany and the Netherlands. The rate of employment among young people was high in Sweden until the early 1990s, but it then fell sharply in connection with the crisis of the 1990s. One factor contributing to this decline is probably the expansion of the education system by universities and colleges which took place at that time and which led to more young people choosing to study instead of participating in the labour force.[5]

The fact that the adult age groups in Sweden have a comparatively high rate of employment is a positive factor. There is no obvious way of evaluating differences in employment rates for young people from country to country from a socio-economic perspective. In the 25–64 age group, the primary alternative to employment is unemployment, or remaining outside the labour force without studying. Many non-employed young people do, however, devote their time to studying, which may of course have positive socio-economic effects in the longer term. Differences between countries as regards employment rates among young people are also linked with the extent to which people who study choose to work at the same time, which in turn is influenced by how the study funding system is structured. One explanation as to why the rate of employment among young people is lower in Sweden than in Germany, for example, is that fewer of the people who study in Sweden are employed during their studies (Figure 3.8, section 3.2). Figure 3.9 also shows that the percentage of young people in Sweden who are not studying and do not have a job or are not participating in any form of apprenticeship is higher in Sweden than in Germany, but the percentage is no higher than the average in other Nordic countries.[6]

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[5] Erikson et al. (2006).
[6] See also section 3.4.3 in Fiscal Policy Council (2014b).

Box 3.1 Development of hours worked per capita

The Council has previously argued that the most comprehensive indicator for illustrating the development of the labour market is the average number of hours worked per capita. This indicator is particularly relevant when studying the labour market in respect of its significance to public sector finances.

Hours worked per capita increase if the rate of employment increases, but also if the average working hours per capita employed increase. In Table 3.1, we have divided the change in hours worked into various elements and study how this has developed overall since the crisis of the 1990s.[7] The number of hours worked per capita increased by just under 6 per cent between 1993 and 2014, primarily due to an increased work effort among women. The increase in the work effort of women is in turn explained primarily by the fact that average working hours increased as a consequence of both an increased attendance frequency (increased percentage of persons employed in work) and longer average weekly working hours. The increase in work effort among men is explained entirely by an increased rate of employment. Average working hours for men have fallen since 1993.

Table 3.1 Decomposition of the change in number of hours worked per capita, 1993–2014

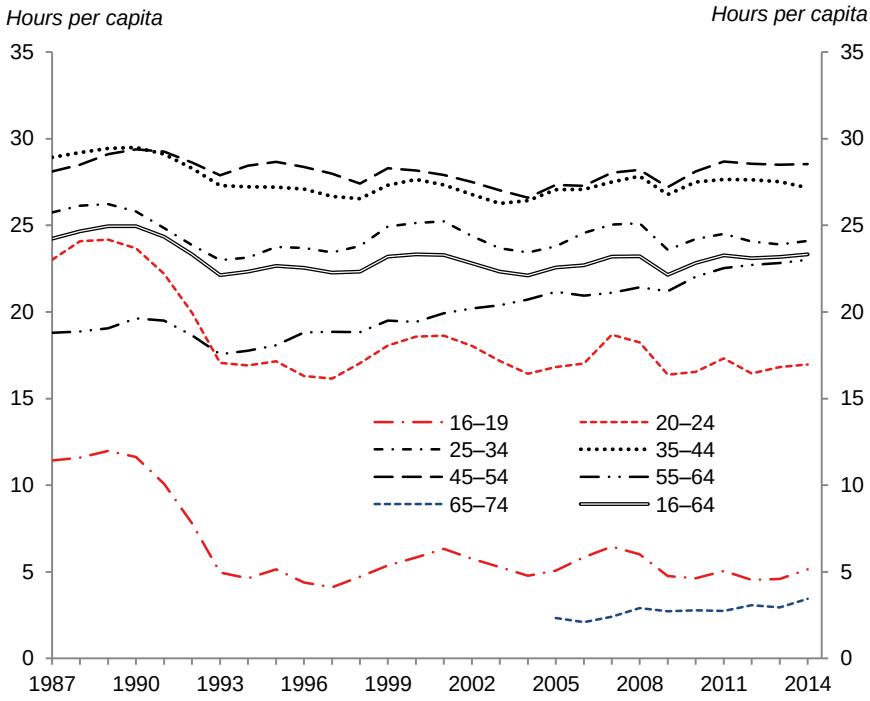
Percentage change	Whole population	Women	Men
Hours worked per capita	5.8	10.0	2.5
Employment rate	4.2	2.4	5.9
Labour force participation	1.8	1.5	2.1
Employed in the labour force	2.4	0.9	3.8
Average hours worked per capita employed	1.6	7.6	-3.4
Percentage of employed in work	1.9	3.3	0.4
Hours worked per capita in work	-0.3	4.3	-3.8

Note: Calculated on the basis of seasonally adjusted data for the 16–64 age group. Changes are stated in cumulative log differences, which approximate the actual percentage change in the respective component.
Sources: Statistics Sweden (2015a) and own calculations.

[7] For a formal description of decomposition in the table, see Chapter 5 in Fiscal Policy Council (2012).

In Figure 3.5, we study instead how the number of hours worked per capita has developed for different age groups. The work effort has increased in the 55–64 age group in particular. The increase in the rate of employment for this age group as seen in Figure 3.1 thus makes an impact in the development in the number of hours worked as well. The 65–74 age group is also working more on average since 2006.[8] The 45–54 age group has also increased its work effort over the past five years.

Figure 3.5 Hours worked per capita per week, by age group



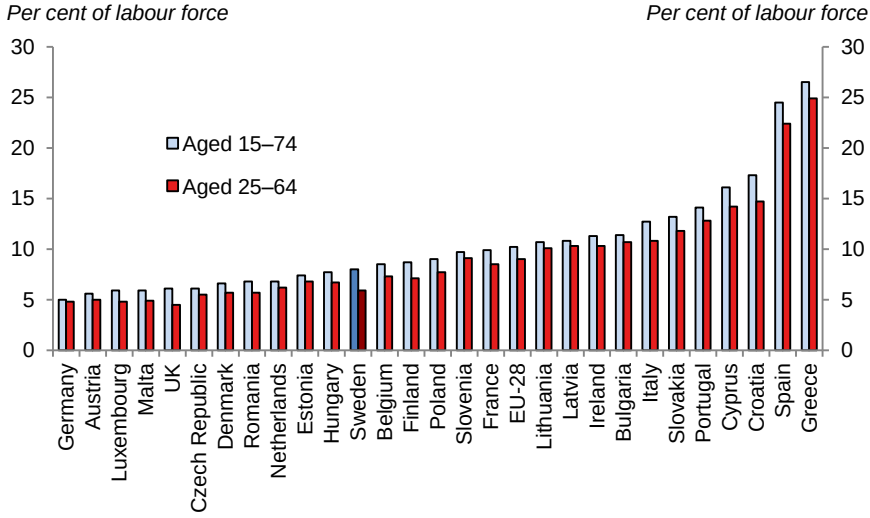
Source: Statistics Sweden (2015a) and own calculations.

[8] The absence of longer time series of hours worked for the 65–74 age group renders it impossible to study the development in this age group prior to 2005.

3.2 Unemployment does not provide as positive a picture

The situation on the labour market looks less positive if we focus on the number of unemployed people as a percentage of the labour force. This figure has fluctuated around 8 per cent since 2011. In other words, the increase in employment which has taken place over the last few years has no more than balanced the increased labour supply. Although Swedish unemployment is not exceptionally high from an international perspective, Sweden comes out considerably worse in international comparisons of unemployment than in comparisons of employment or labour force participation. As can be seen from Figure 3.6 (blue columns), 11 EU countries had lower unemployment than Sweden and 16 countries had higher unemployment in 2014.

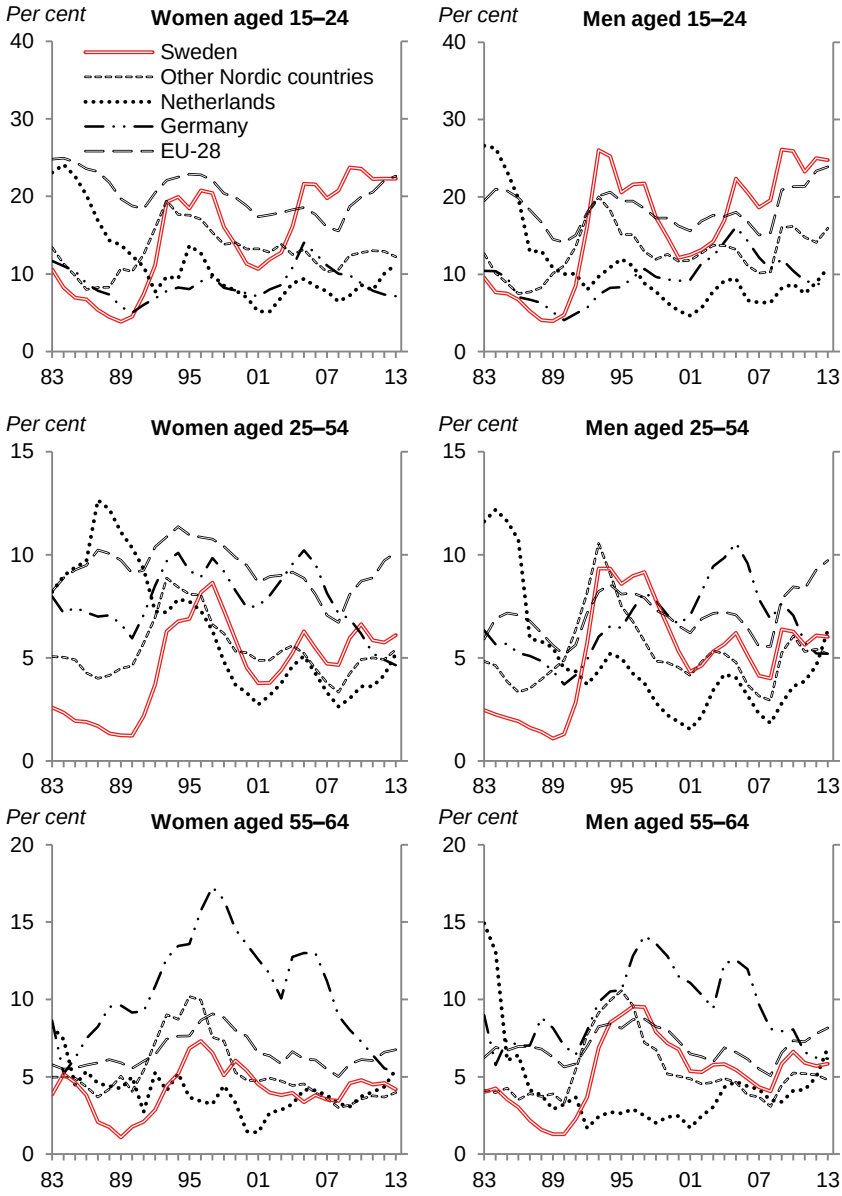
Figure 3.6 Unemployment in the EU, 2014



Source: Eurostat (2015).

Unemployment in Sweden is particularly high in the 15–24 age group compared with other EU countries. We also study the comparison for the 25–64 age group in the figure. As can be seen, Sweden is in a slightly better position in this case: 8 countries had lower unemployment in 2014 and 19 had higher unemployment.

Figure 3.7 Unemployment among men and women in the EU, by age group, 1983–2013



Note: "Other Nordic countries" refers to an average for Denmark, Finland and Norway.
Source: OECD (2015b).

Above is a comparison of unemployment for several different age groups and sexes with a selection of other EU countries (Figure 3.7).

The figures show that unemployment in the adult age groups is not distinctively high in Sweden. For both the 25–24 and the 55–64 age group, unemployment rose at the start of the financial crisis in particular and has receded only slightly since then. Similar development is apparent for the other Nordic countries. In particular Germany deviates in the comparison, with a significant decline in unemployment over the past few decades for both men and women.

Youth unemployment in particular is higher in Sweden than in the other countries in the comparison. Unemployment in the 15–24 age group rose sharply in connection with the crisis of the 1990s but declined after that. It has increased gradually throughout most of the 2000s, more than in the other countries in the comparison.[9] This figure stood at 23 per cent in 2014, compared with 12 per cent in 2001. Germany in particular is exhibiting completely different development to Sweden in terms of youth unemployment. Youth unemployment in Germany has fallen since 2005, from levels close to 16 per cent to 8 per cent in 2014.[10]

However, international comparisons of youth unemployment are affected by differences in education systems, among other things, as specified above.[11] In Figure 3.8 below, therefore, we instead compare the labour market situation for various youth age groups in Sweden and Germany for 2013.

As noted previously – and as is clear from the figure – the most significant difference between Sweden and Germany is the fact that the rate of employment among students is considerably higher in Germany, while at the same time unemployment among students is considerably lower (pink fields in the figures). The fact that German young people doing apprenticeships are deemed to be employed is one probable explanation for the comparatively low level of unemployment among students in Germany. In Sweden, a

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[9] This upturn appears to be linked in part with an increased number of young people aged 15–19 over the first few years of the 2000s. The statistical reform which took place in 2005, when full-time students seeking work started to be counted as unemployed, may also have contributed to the upturn to an extent.

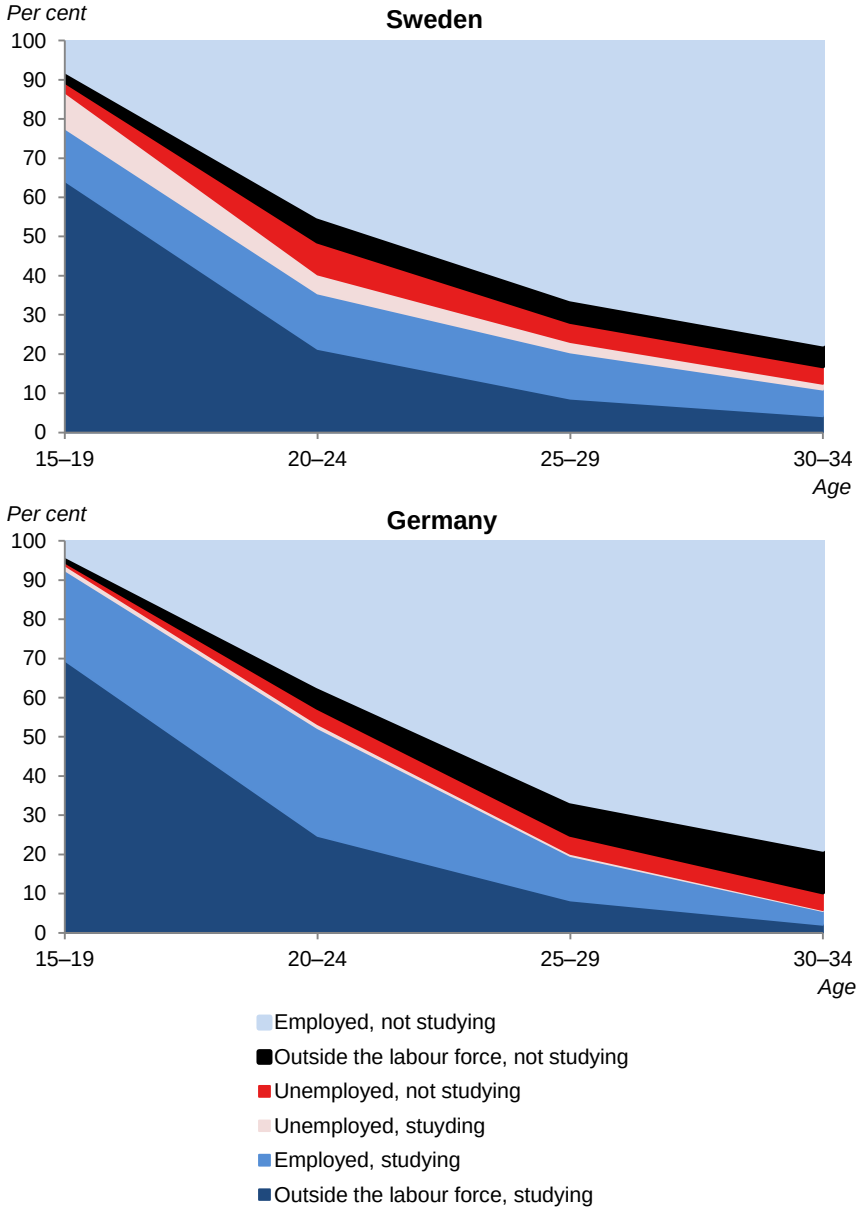
[10] See the National Institute of Economic Research (2014b), pp. 97–99, for a detailed comparison of unemployment in Sweden and Germany.

[11] See Chapter 3 in Fiscal Policy Council (2014b) for a more detailed discussion of problems with the unemployment indicator for young people.

considerably higher proportion of students are unemployed. Moreover, some of the unemployment in Sweden among people who are not students (red fields in the diagrams) is accounted for by students looking for work during the summer break.[12]

[12] See section 3.4.2 in Fiscal Policy Council (2014b) for a breakdown of youth unemployment during the academic year and during the summer months.

Figure 3.8 Young people by labour market status in Sweden and Germany, 2013

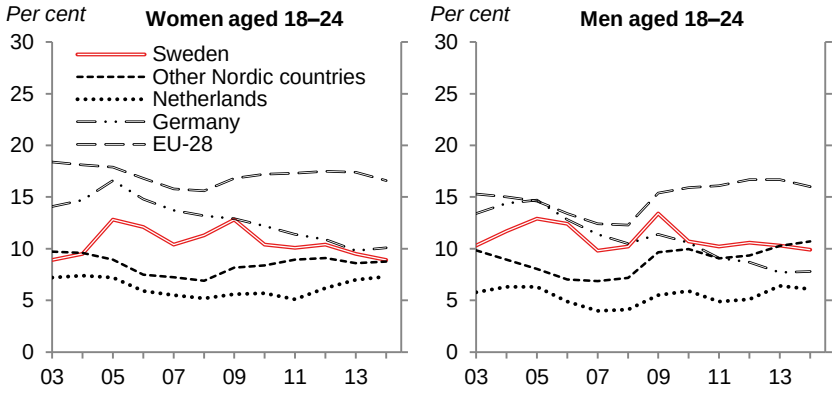


Note: The category of students includes both education and practical work, i.e. people taking part in apprentice systems, education-related practical work or labour market programmes, for example, are all included. Paid practical work is counted as employment.
Source: Eurostat (2015).

Unemployment in Sweden among young people who do not study is, in particular, high in the 19–24 age group, i.e. at the ages at which many young people finish their studies. This indicates that one reason for the higher unemployment among young people in Sweden compared with in Germany has something to do with the transition from education to working life.[13]

One indicator which generally measures establishment problems among young people more effectively than the unemployment statistics is NEET, inactivity among young people. This indicator shows the percentage of young people who are not in education, employment or training (this indicator corresponds to the red and black fields in Figure 3.8). Below, we can see that the Swedish youth labour market measured in this way looks considerably better from a European perspective (Figure 3.9). Compared with Germany, inactivity is higher among young men in particular.

Figure 3.9 NEET by sex



Note: NEET stands for "Not in Education, Employment or Training".
Source: Eurostat (2015).

3.3 Government's target for unemployment

The Government has specified a target for employment policy expressed in terms of unemployment. In BP15 and VP15, this target indicates that "the number of people who work and the hours

[13] See SOU 2011:11 for a more detailed discussion on this.

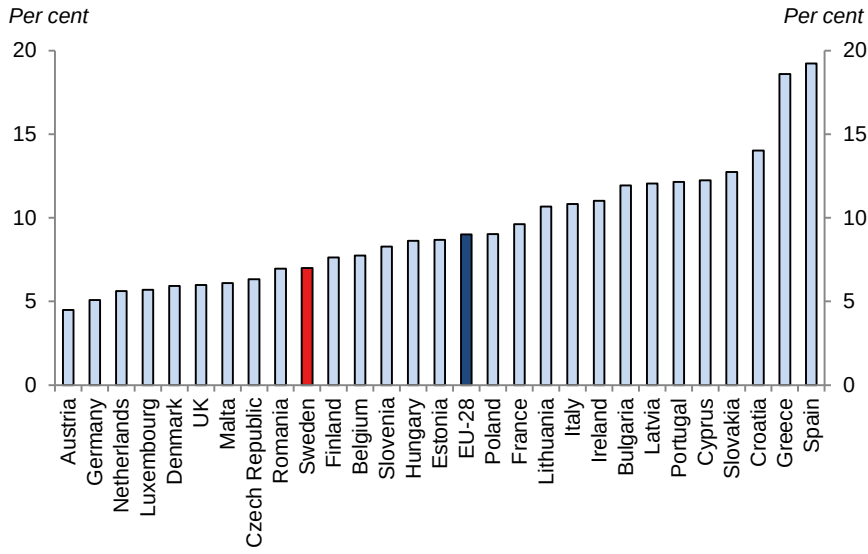
worked in the economy must increase to such an extent that Sweden has the lowest unemployment in the EU by 2020". In comparison with prevailing unemployment levels within the EU, this means that unemployment needs to fall by 3 percentage points in order to reach this target (Figure 3.6).

The fact that this target is based on a comparison with the other EU countries indicates that meeting the target will not be affected by collective fluctuations in the European economic situation. This is a positive aspect of the formulation of the target, as is the fact that the target must be achieved through increased employment.

However, one consequence of the formulation of the target is that there is no reason to believe that the economic recovery expected to take place over the next few years will bring Sweden closer to the target to any great extent.

One alternative way of assessing how far from achieving the target Sweden is at present is to analyse assessments of how high "structural unemployment" (equilibrium unemployment, i.e. unemployment adjusted for cyclical fluctuations) is in different EU countries. Figure 3.10 compares the assessments of structural unemployment in various countries as carried out by the EU Commission.

Figure 3.10 Structural unemployment in the EU, 2014



Source: European Commission (2015a).

The figure indicates that even when effects of differences in the present economic situation have been eliminated, there is a significant difference in unemployment between Sweden and the countries with the very lowest unemployment within the EU. The gap is 2.5 percentage points, according to the EU Commission's estimates of structural unemployment.[14]

For Sweden to be able to achieve its set target of the least unemployment in the EU by 2020, therefore, structural unemployment needs to be reduced significantly. According to the Government's specification of the target, this also has to take place by means of increased employment and not through a reduction in labour force participation. The Council is of the opinion that it will be very difficult to achieve this target.

One reason for this opinion is the fact, specified above, that youth unemployment represents a comparatively large proportion of unemployment in Sweden. As stated above, institutional differences in the education system and students' employment status during their education play a major part in these differences. To a certain extent, therefore, the differences in youth unemployment between Sweden and other EU countries can be expected to persist unless the education system is altered fundamentally.

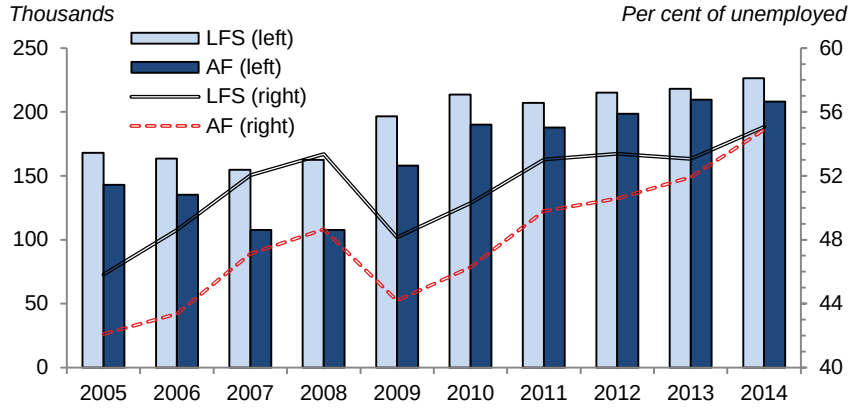
Another reason is that the exceptionally high Swedish labour supply probably reflects the fact that even people with relatively weak job opportunities participate in the Swedish labour market. According to both the official statistics (LFS) and the Swedish Public Employment Service's (AF) statistics concerning people registered as unemployed, people relatively weak job opportunities, vulnerable groups, accounted for more than half of all people unemployed in 2014 (Figure 3.11).

Within the EU countries where labour force participation is lower, it is likely that more of the people with low job opportunities remain outside the labour force. This means that achieving the lowest unemployment level within the EU may present a greater challenge

[14] Estimates of the level of structural unemployment are very uncertain and should therefore be interpreted with caution. The EU Commission estimates that structural unemployment stood at 7.0 per cent in 2014. This must be compared with the Government, which estimates a level of 6.4 per cent. NIER's estimate (6.9 per cent), on the other hand, is close to the estimate of the EU Commission.

to Sweden than to other countries, primarily if the country wishes to retain its high labour force participation.

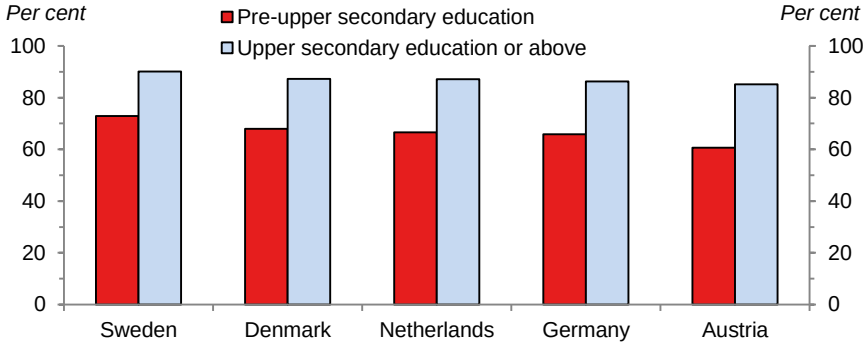
Figure 3.11 Unemployed people in vulnerable groups



Note: Vulnerable groups are people born outside Europe, people with only pre-upper secondary education and people aged over 55 when they become unemployed. The Swedish Public Employment Service also includes people with occupational disabilities in the vulnerable groups. However, LFS figures do not include registration of individuals in respect of occupational handicaps. In order to achieve as much comparability as possible between the Swedish Public Employment Service's (AF) statistics and LFS figures, unemployed people with disabilities who do not belong to any of the other groups as well have been excluded from Swedish Public Employment Service statistics. Unemployed people in the Swedish Public Employment Service statistics refers to people aged 16–64, while the LFS figures relate to people aged 15–74.
Sources: Swedish Public Employment Service (2015), Statistics Sweden (2015a) and own calculations.

One indication that this is the case is that Sweden has relatively high labour force participation among people with low levels of education (Figure 3.12). The figure shows labour force participation for the percentage of the population with only pre-upper secondary education and for people with upper secondary education or above. Germany and Austria, the countries with the lowest unemployment in the EU, have the lowest labour force participation among people with low levels of education of all the countries in the comparison.

Figure 3.12 Labour force participation according to education (25–64 age group)

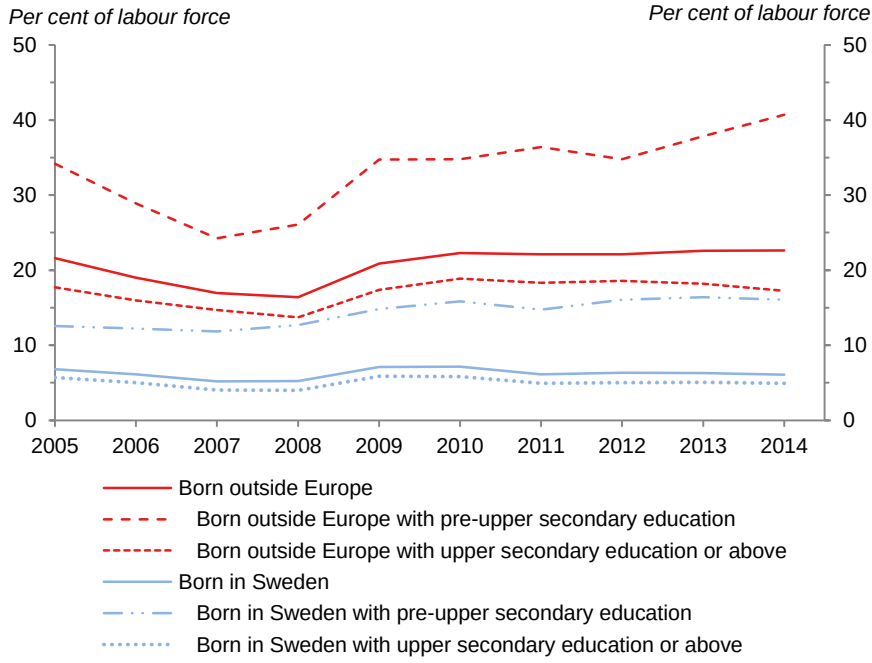


Note: "Minimum upper secondary education" is deemed to be the average of labour force participation for people with upper secondary education and people with post-upper secondary education.
Source: OECD (2014c).

The percentage of vulnerable groups of unemployed people can be expected to increase further in Sweden over the next few years as a consequence of the high level of refugee immigration (see Chapter 2 for migration forecasts) as newly arrived refugees, on average, have more – and longer – periods of unemployment than other groups. As can be seen from Figure 3.13, unemployment is very high among people born outside Europe. Unemployment among people born outside Europe with low levels of education stood at more than 40 per cent in 2014.

This reinforces the view that much of the unemployment in Sweden will persist once the economic situation has normalised, and indicates that the target for a sharp decrease in unemployment will be difficult to achieve. Overall, the Council is of the opinion that it will be very difficult for Sweden to achieve its target of the lowest unemployment in Europe by 2020 by means of increased employment without very significant structural measures.

Figure 3.13 Relative unemployment according to birth region and education level



Note: "People born outside Europe" does not include people born in North America.
Sources: Statistics Sweden (2015a) and own calculations.

3.3.1 The unemployment target and stabilisation policy

In the public debate, some people have advocated that unemployment should be tackled by pursuing a more expansionary fiscal policy which further fuels demand in the economy and hence the demand for labour force. One argument in favour of such a policy is that this would allow fiscal policy to prevent cyclical unemployment becoming structural in that individuals are ejected from the labour market after a long period of unemployment. The Council is of the opinion that the research supports the fact that stimulating demand during an economic downturn may have certain residual effects on unemployment by reducing the risk of persistence, i.e. unemployment being perpetuated at a high level once it has passed its equilibrium level. That said, there is nothing to support the

fact that a policy of this kind would lead to permanently lower unemployment.[15]

The appropriateness of pursuing an expansionary policy must also be assessed on the basis of the economic situation. In Chapter 1, the Council stated that the economy is no longer particularly far from normal capacity utilisation. NIER and the Riksbank expect normal capacity utilisation to be achieved as early as next year. The opinion of the Government is that it will take a further year to achieve. There is a risk that pursuing an already expansionary fiscal policy in an even more expansionary direction in such a situation would have a destabilising effect, partly because the effects of economic policy measures generally lag behind.

The Council is also of the opinion that there is reason to be sceptical as regards the extent to which the type of fiscal initiative discussed in the context, such as government investments in infrastructure and housing, would lead to increased employment for the groups of unemployed people who are most detached from the labour market.

3.4 Effects of the Government's proposals

In BP15 and VP15, the Government presented a range of measures with a view to reducing unemployment. These relate primarily to extended and amended initiatives in labour market policy and more places in adult education and at folk high schools. The most extensive measures in terms of costs are a 90–day guarantee for young people – an ultimate limit for how long a young person can be registered as unemployed without action been taken – and additional services in the welfare sector for the long-term unemployed. Subsidised employment in the form of trainee jobs and the above-mentioned initiatives involving adult education and folk high schools are important elements of this guarantee for young people. Additional services must be subsidised employment at contractual wages and replace the present Phase 3 within the work and development guarantee. The Government is also proposing changes to integration policy, primarily measures with a view to improving

[15] See, for example, Chapter 2 in SOU 2011:11 and Bergman (2010).

the validation of education from other countries and facilitating supplementary training at higher education level.

In the opinion of the Council, these measures may have a certain positive effect on employment. Research indicates that subsidised employment which resembles regular employment performs better than other subsidised work.[16] At the same time, the displacement effects on employment from measures of this type can be assumed to be extensive. As regards training initiatives for young unemployed people, there is reason not to expect particularly great lasting employment effects. Studies indicate that it is generally difficult to compensate for educational underachievement early on in life with later training measures.[17] Measures for improving integration are central to employment policy, but it is important to formulate these so that they also include the group of low-education immigrants from countries outside Europe where unemployment is highest. Overall, the Council is of the opinion that the measures presented by the Government to date will probably have no more than a fairly small effect on unemployment, particularly in relation to what the unemployment target demands.

In VP15, the Government also proposes measures – a higher ceiling for unemployment insurance and increased social security contributions for young people – which may be judged to have the opposite effect and increase unemployment.

The proposal regarding increased social security contributions for young people means that the reduction implemented by the previous government will be taken away. An estimate of what this will mean for employment can be found in the study carried out by IFAU on the previous reduction. It was thought that the reduction in social security contributions for young people would increase employment among young people by 6000–10,000 jobs in the short term.[18] However, in the opinion of the Council it is likely that the lasting employment effects will be less extensive as the estimates did not take into account displacement effects, i.e. the fact that employers can opt not to employ individuals who are just above the threshold in favour of younger, cheaper labour.

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[16] Calmfors et al. (2002) and Forslund and Vikström (2010).
[17] OECD (2015a) and Gustafsson et al. (2014).
[18] Egebark and Kaunitz (2013).

The effects of the changes to unemployment insurance will be discussed in the next section.[19] Effects on both employment and income distribution are discussed in the section. Research shows that more generous remuneration leads to higher unemployment in that unemployment periods are extended and wages increase by more than would otherwise have been the case.[20] However, more generous remuneration also means improved income protection for anyone affected by unemployment, and therefore leads to more even income distribution. It should also be noted that the ceiling for unemployment insurance has nominally remained unchanged since 2002, and that this has involved very extensive erosion of public insurance cover over the past 13 years.

Overall, the Council is of the opinion that the measures presented by the Government to date are far from sufficient in order to achieve the unemployment target, and this is also the opinion of the Government. Changes to labour market policy may have a certain effect on structural unemployment, but for unemployment to approach the lowest levels within the EU more thorough reforms of the labour market are highly likely to be needed. The formulation of Swedish employment protection and the level of the minimum wages based on collective bargaining are examples of areas in which the labour market appears to perform poorly.[21] However, measures within these areas do at the same time involve conflicts with other economic policy targets in similar ways to changes in respect of unemployment insurance. The comparison with Germany also indicated that the target may be difficult to achieve without reforming the education system so that fewer students are deemed to be unemployed and more are deemed to be employed. However, it is not appropriate to allow this rather mechanical aspect to provide guidance for the formulation of education policy.

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[19] BP15 included a further range of proposals for tax changes. The Government proposed – among other things – scaling down the earned income tax credit, a special payroll tax for the elderly, and upward adjustment of the threshold for national income tax. Such changes to the direct taxation of individuals affects both income distribution and employment. However, the Riksdag voted down the Government's proposal. In VP15, the Government writes that they will come back with proposals for tax changes in the autumn budget bill. We await these proposals and will revert with a discussion of them once they have been presented.

[20] For a theoretical and empirical overview, see – for example – Tatsiramos and van Ours (2011). See Forslund (2008) for a summary of empirical results for Sweden.

[21] SOU 2011:11 and OECD (2015a).

Therefore, unilaterally focusing the policy on achieving the target for unemployment will probably require compromises with other targets within economic policy. However, for a constructive discussion on the focus of economic policy, target conflicts have to be disclosed openly and policy considerations have to be clarified. Section 3.5.2 below states that the Government has chosen not to disclose any crucial considerations as regards the proposed changes to unemployment insurance. The Council is of the opinion that this is unfortunate.

3.5 Effects of increasing the unemployment benefit scheme

3.5.1 Distribution effects

The Government proposed in VÄB15 that the maximum daily allowance relating to unemployment insurance should be increased from SEK 680 to SEK 910 for the first 100 days of a remuneration period, and then from SEK 680 to SEK 760. The maximum daily allowance relating to the basic insurance should be increased from the current SEK 320 to SEK 365 per day. This change will come into force on 7 September this year. Effects on income distribution are analysed below using calculations in the FASIT model which the Council has commissioned NIER to perform.[22]

This proposal means that anyone who reaches the ceiling with the applicable rules or who merely has the basic insurance will receive a higher payment. As the ceiling for the insurance is equivalent to a

[22] The Government's proposal in VÄB15 to increase remuneration in the unemployment insurance scheme is very similar to the proposal presented by the Government in BP15. (In BP15, it was proposed that the basic amount in the insurance should be increased to SEK 350 per day, while the proposal in VÄB15 involves an increase to SEK 365 per day.) As there has not been much time between VÄB15 and the Council's report, we have chosen to work on the basis of an analysis of the proposal included in BP15. The analysis is based on an assumption that the rule change came into force on 1 January 2015. A detailed analysis can be found in NIER (2015b). This also includes an analysis of a number of other measures which were included in BP15, such as limited tax deductibility for private pension savings, gradual reduction of earned income tax credits for employment income exceeding SEK 600,000, limited upward adjustment of the lower threshold, an increased personal allowance for the elderly and a remuneration rate for sickness and activity compensation. The proposal relating to tax deductibility for private pension savings was also included in the Alliance's budget motion which was adopted by the Riksdag in December 2014. The other five proposals from BP15 have not yet been adopted by the Riksdag.

full-time wage of SEK 18,400 per month, many people reach this ceiling.[23] One uncertainty factor as regards estimates of how many people will actually receive more money if they become unemployed, however, is the role played by supplementary income insurance schemes in the actual remuneration level. Over the last decade, it has become more common for people to take out supplementary insurance schemes which replace incomes in excess of the ceiling for the unemployment insurance scheme. Most people who have such insurance have acquired it through collective bargaining agreements between trade unions and employers, or via their trade union organisations, but it is also possible to take out a policy independently. It is difficult, from available statistics, to get a good idea of how many people have further income protection in this way, as the various insurance policies overlap one another.[24] The FASIT model includes estimates of the insurance policies resulting from the collective bargaining agreements, but not the policies that can be concluded via the trade union organisations or the separate income insurance schemes which individuals can have. This means that FASIT probably slightly overestimates the effects of the penetration of the rule change on income distribution and employment.

Short-term effects

Figure 3.14 shows the short-term effects on income distribution. The columns show how the adjusted disposable incomes change on

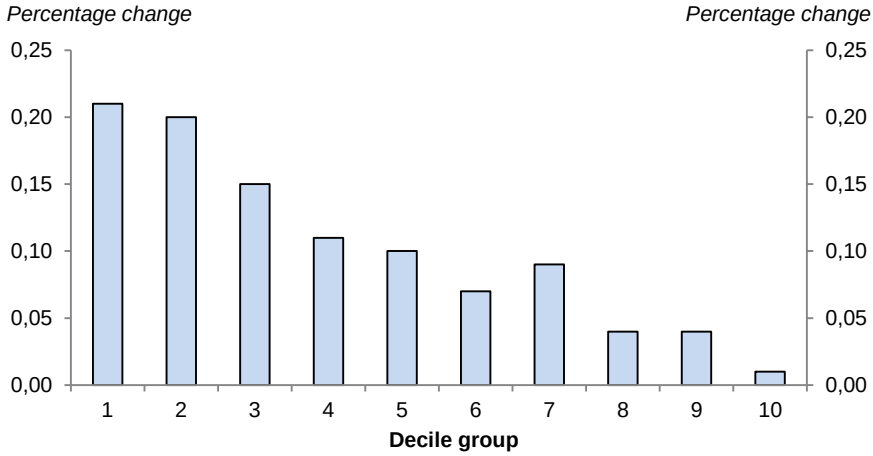
[23] The median pay for 2013 was SEK 27,300 per month. Source: Statistics Sweden.

[24] In 2010, the Council implemented a survey on supplementary insurance schemes. The Council found that surprisingly few unemployed people received remuneration from supplementary insurance schemes. Of all the people interviewed, only 9 per cent stated that they had supplementary income insurance. 15 per cent of respondents had incomes from the unemployment insurance scheme, and 24 per cent of them reached the ceiling. As knowledge of these insurance schemes can be assumed to be lacking, the survey also included a question on trade union affiliation. Of all respondents, more than 20 per cent stated that they were not sure or did not have an insurance policy, but that they were part of a trade union where such insurance is included in the membership fee. It turned out that many people had poor awareness of their insurance situations. As so few people stated that they received remuneration from a supplementary income insurance scheme, while at the same time awareness of the insurance schemes appeared to be lacking, the Council was of the opinion that there was reason to believe that many people do not utilise the insurance benefits to which they are entitled. To receive remuneration from these insurance schemes, it is necessary to apply for it. If many people are unaware of this, they will not receive any remuneration from the supplementary insurance schemes.

average for each decile group, given individuals' original decile group affiliation.[25]

As household consumption is being analysed here, the proposal will lead to higher incomes in all decile groups. The effect on adjusted disposable income is greatest in decile groups 1 and 2, as unemployment benefits constitute a greater proportion of incomes in these groups. Decile groups 3 to 7 are also affected to a relatively great extent.

Figure 3.14 Change in adjusted disposable income as a consequence of increased remuneration in the unemployment insurance scheme, 2015



Note: The direct effects are the income increases that occur immediately after the tax rules change. The columns show the percentage change of the average for the people who belonged to each decile group prior to the rule changes.
Source: NIER (2015b).

Long-term effects

Long-term distribution effects mean that attention has been paid to how the labour supply is adapted to the rule change. The proposed increase will give a relatively small reduction in hours worked in the long term. As regards the interpretation of this result, however, it ought to be noted that the model used is a labour supply model (linked with FASIT). It does not take into account effects on labour

[25] The adjusted disposable income for a household is the disposable income divided by the household's consumption weighting according to the Swedish consumption unit scale.

force demand. Therefore, any effects of the proposed change on wage formation are not included. We will continue the discussion of the employment consequences of the proposal in section 3.5.2.

Calculations of the long-term effects indicate that women reduce their labour supply more than men (Table 3.2). The greatest reduction can be seen in quartile group 3. The greatest changes take place via what is known as the extensive margin, i.e. individuals move from work to unemployment (or to the "other" group). The labour supply is reduced to the smallest extent in the lowest quartile. There is no effect on the extensive margin in this group.

Table 3.2 Labour supply effects (changes)

	Total	Quartile group				Gender	
Per cent, number		1	2	3	4	Women	Men
Hours worked (%)	-0.09	-0.04	-0.06	-0.16	-0.06	-0.11	-0.07
Annual work units[1]	-4,413	-138	-538	-2,461	-1,277	-2,477	-1,936
Intensive margin							
Annual work units[1]	-320	-119	-272	12	58	-145	-176
Extensive margin							
In work[2]	-3,656	-238	-306	-2,037	-1,075	-2,129	-1,527
Unemployed[2]	3017	0	306	1,636	1,075	1,644	1,373
Sick[2]	0	0	0	0	0	0	0
Pensioners[2]	0	0	0	0	0	0	0
Other[2]	639	238	0	401	0	486	154

Note: The table shows the simulation effects obtained from FASIT.
[1] One annual work unit is equivalent to 1800 hours.
[2] The number of people that have changed status as a consequence of the changes.
Source: NIER (2015b).

Table 3.3 shows how income distribution measured by the Gini coefficient is affected.

Table 3.3 Change in decile limits in comparison with the median (increased remuneration in the unemployment insurance scheme)

	Before rule changes	After rule changes	Difference	Percentage change
p10/p50	0.554	0.560	-0.006	-1.10%
p20/p50	0.677	0.678	-0.002	-0.24%
p30/p50	0.794	0.795	-0.001	-0.12%
p40/p50	0.897	0.898	-0.001	-0.08%
p50/p50	1.000	1.000	0.000	0.00%
p60/p50	1.116	1.116	0.001	0.05%
p70/p50	1.244	1.244	0.000	0.02%
p80/p50	1.423	1.423	0.000	-0.02%
p90/p50	1.686	1.687	0.001	0.06%
Median=p50	233,109	233,108	0	
Gini	0.272	0.271		

Note: In the fourth and fifth columns, the values have been normalised so that a positive value means that the distance to the median has increased and a negative value that it has decreased. Column four shows the difference between the values in columns two and three. Column five shows the values in column four as a percentage of the values in column two. The values in columns two to five have no units.
Source: NIER (2015b).

The increase in unemployment benefits results in a slightly more even income distribution: the Gini coefficient is reduced by approximately one-thousandth. Besides the compressive effect in the lower part of the income distribution, there are also a number of changes in the upper half of the distribution. The income dispersion increases slightly in the upper half of the income distribution.

3.5.2 Calculations of employment effects

The Government has not provided an analysis of the employment effects of increasing remuneration in the unemployment insurance scheme in either BP15 or VÄB15. Nor did BP15 include any such analysis of other proposals with obvious effects on employment, such as gradual reduction of the earned income tax credit. The Government has presented such estimates previously.[26] The Council is of the opinion that the Government failing to present estimates of

[26] See, for example, BP14, Table 1.9, p. 51.

employment effects is a serious shortcoming. In purely general terms, the Government should always present analyses of anticipated employment effects for the proposals presented in its bills.

Working on the basis of how the Ministry of Finance has previously assessed changes to unemployment insurance, the Council has made its own estimates of the employment effects of the proposed increase. These indicate that unemployment will increase by approximately half a percentage point in the long term as a consequence of the increased remuneration levels in the unemployment insurance scheme. This estimate is based on estimates of the extent to which the remuneration level can be expected to be increased. The remuneration level is the average disposable income during unemployment in relation to the disposable income during employment, and is an indicator of the profitability of working compared with not working. According to calculations in the FASIT model commissioned from NIER by the Council, the proposed increase in unemployment benefit means that the remuneration level will increase by more than four percentage points.[27] The 2011 report "Hur ska utvecklingen av arbetsmarknadens funktionssätt bedömas?" [How should the development of the labour market's function be assessed?] states that the Ministry of Finance has made the assessment that the quasi-elasticity stands at 0.12. This means that if the remuneration level increases by 4 percentage points, equilibrium unemployment will increase by approximately 0.5 percentage points, which is equivalent to approximately 27,000 fewer people employed.[28]

In VP15, the Government provides notification that the methods for calculating behavioural effects of reforms must be reviewed. The Council welcomes the fact that the Government is constantly developing its methods, but is of the opinion that future method development cannot excuse the absence of calculations for the proposals now been presented.

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[27] The Ministry of Finance does not use the FASIT model to make assessments of the employment effects of a change in remuneration level, but instead uses the unemployment statistics from the Swedish Public Employment Service. However, the Council does not have access to these statistics.

[28] See the memo from the Fiscal Policy Council (2015) for a description of these calculations.

3.6 Assessments and recommendations

The Council is of the opinion that the Swedish labour market is developing well in a number of respects. Sweden had the highest rate of employment and the highest labour force participation in the EU in 2014.

That said, things are less positive as regards unemployment. Eleven EU countries had lower unemployment than Sweden in 2014, and 16 countries had higher unemployment.

Above all, unemployment among young people is higher in Sweden than in the countries with the lowest unemployment in the EU. A comparison between Sweden and Germany indicates that this is partly due to the fact that Sweden has a higher proportion of young people who are unemployed (and fewer who are employed) alongside their studies. Unemployment among young people in Sweden is also comparatively high during the transition from education to working life.

The Government's target is for Sweden to have the lowest unemployment in the EU by 2020 and that this target is to be met by increasing the number of people who work and the number of hours worked in the economy. The Council welcomes the Government's express indication that the target will be achieved by increasing employment, but also notes that Sweden is far from meeting this target.

In VP15, the Government estimates that unemployment will fall over the next few years, from 7.9 per cent in 2014 to 6.4 per cent in 2018. Given the way in which the target is formulated in relation to other EU countries, it is unlikely that this development will bring Sweden all that much closer to its target. The fact that unemployment is expected to fall is due to an improvement in the economic situation which is largely shared throughout the EU. According to the EU Commission's assessment of structural unemployment, i.e. the unemployment that can be expected to persist during a normal economic situation, this needs to be reduced by more than 2.5 percentage points as far as Sweden is concerned if Sweden is to have the lowest unemployment within the EU. This is equivalent to approximately 130,000 jobs.

We are of the opinion that such an enormous reduction in structural unemployment will be very difficult to achieve. Above all,

this will require compromises with distribution policy targets for the policy for the unemployment target to come within reach. The types of measure that would be needed in order to permanently increase employment, such as reduced unemployment benefits and lower payroll costs, would at the same time mean more uneven income distribution. The development in Germany is an illustrative example of these target conflicts. German unemployment has fallen sharply since the mid-2000s, but at the same time the proportion of low-paid jobs has increased significantly.[29]

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. The extended volumes and initiatives for improved quality within the education system which the Government is planning to implement will probably also have certain positive employment effects. However, by all accounts these will be small effects compared with what is needed to achieve the unemployment target. The Government has also announced measures – the abolished reduction in social security contributions for young people and the increased benefit levels in unemployment insurance – which will lead in the opposite direction. Conventional calculation methods indicate that the abolished reduction in social security contributions for young people and the increased remuneration levels in respect of the unemployment insurance scheme can be expected to reduce employment by more than 30,000 people.

The Council notes that the Government has chosen not to disclose itself employment effects of the planned changes to the unemployment insurance scheme. The Council is of the opinion that this is unfortunate. In VP15, the Government writes that the methods for calculating the effects of economic policy measures must be reviewed. Future calculation audits, in our opinion, are not an acceptable justification for failing to disclose results at present based on the current methods.

The measures in respect of the unemployment insurance scheme are a clear example of the factors that have to be taken into account between distribution policy targets and employment policy targets.

[29] OECD (2014b).

The Council is of the opinion that it is clear that the Government is prioritising distribution policy effects in the policy now announced. There are good arguments in favour of increasing remuneration in the unemployment insurance scheme, which in real terms has been in decline for a long time and currently provides very poor income protection in the event of unemployment. We are also of the opinion that phasing out the gradual reduction of social security contributions for young people is justified as the employment losses will probably be minor in relation to the central government cost.

Economic policy is, to a significant extent, all about making trade-offs between different targets which conflict with one another to a greater or lesser extent. For a constructive discussion on the focus of economic policy, such target conflicts have to be disclosed openly and policy considerations have to be clarified.

The Council perceives a risk associated with the fact that the target conflicts that exist between the target of achieving the lowest unemployment in the EU by 2020 and other economic policy targets have not been made clear by the Government. The target conflict between the unemployment target and other economic targets can be masked temporarily by the Government by undertaking measures which reduce unemployment in the short term or in purely statistical terms. Credit-financed fiscal stimuli are one example of such measures. It is possible to temporarily achieve lower unemployment through further fiscal expansion (and, in the long run, credit-financed overheating). Such a policy may create a temporary increase in demand for the labour force which is currently far removed from the labour market. However, established research indicates that any such policy has minor or no permanent effects on unemployment. On the other hand, there is a risk of it damaging confidence in stable, long-term fiscal development. It is also important for the Government to stand by its ambition to reduce unemployment by increasing employment and the number of hours worked. It would be inappropriate to improve unemployment statistics by reducing incentives to participate in the labour force among groups with a weak labour market position. Such measures would risk impairing conditions for high employment sustainable in the long term.

4 Retirement age and long-term sustainability

Long-term sustainability assessments for government finances normally assume that the pension system is independent and financially stable. However, as the average lifespan increases, the stability of the pension system is achieved at the expense of general pensions on average gradually being reduced in relation to pay. In this chapter, we will discuss the significance of retirement age to both the level of future pensions and the long-term sustainability of government finances.

4.1 Falling remuneration rate in the public pension system

The structure of the pension system, with an automatic balancing mechanism, ensures that the system is sustainable in the long term by limiting the upward adjustment of pensions if the liabilities in the system are greater than its assets. At the same time, however, for the pension system to be mechanically sustainable, what is known as the remuneration rate – i.e. pensions on average in relation to pay – must be reduced if the number of pensioners increases in relation to the number of people in gainful employment.

This is a defined-contribution pension system; in other words, the level of the pension contributions is predefined, while the level of the pensions is determined by how much income to the pension system is generated per pensioner by these contributions. The income element of the public pension is financed by a charge of 16 per cent of what is known as the pension base, which is made up primarily of earned income. The basic principle of this system is that the pension contributions paid by the working population are paid directly to pensioners. The premium element of the public pension is financed by a charge of 2.5. per cent in addition to this. Unlike the public pension, these charges are invested and paid out only when the person who paid them retires.

Long-term demographic estimates indicate that the average lifespan will continue to increase and will be approximately 7 years longer in 2099 than is the case at present. If retirement age is not

changed, this means that the entire longer life will be spent as time in retirement. This means that the pension contributions paid while people are active will need to be distributed over a larger number of retirement years. In principle, this system is robust in respect of such a development in that pensions are automatically reduced in relation to pay. This is a purely mechanical effect of the structure of the pension system. However, a development whereby pensions are gradually reduced in relation to pay risks being perceived as unacceptable in the long term, which justifies concerns that the system may perhaps not be politically robust.

4.2 NIER's calculations of long-term sustainability

The National Institute of Economic Research disclosed calculations of the long-term sustainability of government finances in the latest issue of Konjunkturläget (March 2015), and at the same time published a special study of long-term sustainability.[1] These calculations are based on Statistics Sweden's population forecast and are founded on a number of central assumptions: firstly, it is assumed that retirement age will remains unchanged; secondly, it assumes that the need for nursing and care for the elderly will be the same as at present at every age; and thirdly, maintenance of what are known as public sector commitments is assumed. In NIER's calculations, maintenance of public sector commitments mean that personnel density per user will remain unchanged in the public services, and that central government investments will follow the development of GDP, and also that the social transfers will follow wage development. It may be noted that this involves a gradual increase in the standard in general government, as a presumed productivity increase will remain within the sector and not be reflected in the form of a reduction in workforce.

NIER's calculations indicate that the public finances in this base scenario, as it is known, are not sustainable in the long term. For public finances to be sustainable in the long term while at the same time maintaining general government commitment, the public

[1] NIER (2015a).

finances would need to be reinforced immediately and permanently by no less than 5.6 per cent of GDP.

The National Institute of Economic Research has also created calculations in order to examine how susceptible public finances are to changes to retirement age and health. For retirement age, NIER has assumed that this will gradually increase in proportion to the average lifespan in line with the proposal of the Government Commission for Longer Working Life and Retirement Age.[2] These calculations mean that of the longer life, approximately two-thirds will be spent in work and one-third in retirement, i.e. the proportions between work and retirement will be maintained at more or less their present level. This means that working life will be extended by approximately 5 of the 7 years by which the average lifespan is expected to increase by 2099.

The calculations for health mean that when the average lifespan increases, age-related illnesses will also occur later. Such a development would be of major significance to public finances as lives will then be extended with years of good health. In the NIER scenario, it is assumed that health will improve by five years to 2099, so – for example – a 75–year-old in 2099 will be as healthy as a 70–year-old at present.

Both of these changes are of major significance to the development of public finances, but neither of them will suffice alone to bring about finances which are sustainable in the long term. However, if the two are combined, this would indicate – according to NIER – that the public finances are sustainable in the long-term with no major need for tax increases. In other words, according to this calculation public finances will be sustainable in the long-term with an increased number of elderly people and an increasing average lifespan if working life is extended at the same time and the health of the elderly is improved. However, this estimate does not include the risk of the pension system potentially being perceived as so parsimonious that requirements for contributions from the Treasury will be necessary.

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[2] SOU 2013:25.

4.3 Necessary to increase retirement age

As the average lifespan increases, so the number of pensioners to be supported by each person in gainful employment will increase, unless the retirement age increases in proportion to the increase in average lifespan or the population growth increases. Pensions will then be lower in relation to pay. The pensions system is stable in the sense that such a reduction in the relative value of pensions takes place automatically. NIER's calculations are based on an assumption of no change to public sector commitments. However, for pensions the starting point is that the present pension system will continue to apply. This means that pensions will not follow wage development, but that they will gradually decline in relation to pay. It should be borne in mind that the reasonings and calculations in the section refer to the public pension system. Occupational pensions or purely private pension solutions are not taken into account. For people with occupational pensions and with long employment periods, pension levels are considerably higher than as specified in these calculations.

The reduction in the pension system's remuneration rate risks becoming so great that it will be perceived as unacceptable. If the retirement age remains unchanged, NIER estimates that average pensions will fall from the current level of approximately 45 per cent of pay to approximately 27 per cent by 2099, if premium pensions are included. The reduction will be relatively quick after 2020, and it is estimated that the remuneration rate will have fallen to approximately 35 per cent by 2040. Without premium pensions, pensions are estimated to amount to approximately 30 per cent of pay in 2040, and it is thought that they will have fallen to 22 per cent by 2099. If working life is extended by approximately two-thirds of the increased lifespan, this reduction will not be as sharp but it will still be significant. Pensions' proportion of pay will fall to approximately 38 per cent by 2040 and then continue to decline slightly before reaching a level of approximately 35 per cent in 2099, including premium pensions.

The reduction in the remuneration rate is primarily explained by two factors: the phasing in of the new pension system, which is less generous than the old one, and the increasing average lifespan.

The Council has asked NIER to calculate what would be required to maintain pensions on a par with the current level in relation to

pay, i.e. amounting to approximately 45 per cent of the average wage in the long term as well. Imposing such a condition would involve having to reinforce public finances by approximately a further 3 per cent of GDP, in addition to the 5.6 per cent of the base scenario, in order to be sustainable in the long term. A scenario of this kind, i.e. with no change to the remuneration rate in combination with no change to retirement age, would result in the pension system itself being massively underfinanced and the buffer funds for the pension system being eliminated. The deficit would need to be covered by means of large transfers from central government.

The Council has also asked NIER to perform calculations of the extent to which retirement age would need to be increased for it to be possible to maintain the remuneration rate at the current level.[3] NIER has calculated four alternatives. Three scenarios involve increasing the retirement age from 65 to 71 at different rates, from a rapid increase over approximately 8 years to a slower increase over almost 30 years. The fourth alternative involves upward adjustment of retirement age by two-thirds of the increased average lifespan, which will result in a retirement age of 69 from 2053.

Such an increase is in line with what the Swedish Pensions Agency wrote in 2013 in what is known as its orange report:

> *Of the total increase in lifespan, approximately two-thirds need to be added to working life in order to achieve the same pension level, while one-third of the increase in lifespan can be added to the retirement years.*[4]

None of the alternatives is entirely capable of maintaining the remuneration rate at a constant level. In all scenarios, the remuneration rate is calculated to fall until about 2030 as long as the old pension system continues to be phased out. After that, the remuneration rate will rise but not reach the 2013 level in any of the cases. If retirement age is increased by two-thirds of the increasing average lifespan, this will stabilise the remuneration rate at a level which will involve pensions being approximately 20 per cent lower in relation to pay compared with the present situation. Such a reduction may very well be perceived as unacceptable.

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[3] NIER has performed simulations using the Swedish Pensions Agency's model, which extends until 2060.

[4] Swedish Pensions Agency (2013), p. 61.

In our opinion, an increase in retirement age is entirely necessary in order to maintain acceptable pension levels and create conditions for public finances which are sustainable in the long term. There is no statutory retirement age; instead, the decision to retire is based on a number of different factors relating to conditions for pension withdrawal, etc. That said, there is a strong norm linked to both public and agreed pension rules which causes people to retire at the age of 65. We consider it very important to gradually move upwards the limit of what is regarded as a normal retirement age.

If retirement age increases by one month per year, working life – all things being equal – will increase by seven years by the end of this century. As seven years also corresponds to the forecast in respect of the extent to which the average lifespan is estimated to increase until then, this would mean that the entire increase in lifespan is taken up by a longer working life. According to estimates that have been carried out on our behalf, increasing the retirement age by one month per year would probably not suffice to maintain the current remuneration rate of the pension system.

The estimates indicate a significant problem. Increasing retirement age by one month per year must be said to be ambitious and optimistic. At the same time, such an increase would not suffice to maintain current remuneration levels. The only solutions to this problem are: (i) to accept reduced payments, (ii) to increase pension contributions, (iii) to sharply increase the level of the surplus target to be able to finance future transfers to the pension system, or (iv) to increase retirement age more quickly than the increase in lifespan.

We are of the opinion that greater political attention should be paid to increasing the retirement age, and as a first step retirement age increasing by one month per year should be built into agreements and pension rules. What is known as the LAS age, i.e. the entitlement to continue working, should be increased at the same pace. It is essential to get people out of the habit of retiring at the age of 65. An arrangement whereby automatic "revaluation" takes place each year would be preferable in place of an arrangement whereby repeated decisions would need to be made on measures for increasing retirement age. Automatic "revaluation" will create predictability and help provide a general insight indicating that retirement age is not set in stone but needs to be adjusted upwards on a rolling basis as the

average lifespan increases. Such an insight is crucial if the pension system is to be sustainable in the long term.

The prerequisites for being able to continue working as people get older vary between various labour market groups. Extending the working life of groups of people whose work is physically arduous may be difficult. This may create increased distribution policy-related tensions within the pensioner community which may need to be countered by means of compensatory action. However, the fact that not everyone is capable of working for longer must not be allowed to become an argument in favour of nobody doing that. With more elderly people and an increasing average lifespan, extending the working life will be necessary.

The Government Commission for Longer Working Life and Retirement Age published its conclusions in 2013, with the primary message being that as we live for longer, so it will be necessary to carry on working for longer than we do at present. The Commission submitted a series of proposals to encourage participation of the elderly in working life, and also to introduce what is known as a guide age which would be linked to age limits in the pension system and adjacent systems and be gradually increased as the average lifespan increases. There is a major need to implement these proposals, or similar ones. If the retirement age fails to increase at a relatively fast pace, there is a risk of postponing major central government finance problems until a future time.

4.4 Assessments and recommendations

The sustainability assessments from the Government and NIER assume that the pension system is stable and autonomous. However, the rules of the pension system mean that pensions are gradually declining in relation to pay. NIER's calculations indicate that the remuneration rate in the public pension system will be halved by the start of the next century if the retirement age remains unchanged. There is reason to doubt that a gradual decrease of this kind in the relative value of pensions would be regarded as acceptable.

The average lifespan is estimated to increase gradually and is expected to increase by approximately 7 years in this century. If the retirement age remains unchanged, this entire extra lifespan will be taken up by time in retirement. If the time in retirement is extended

and the time in work does not change, earned pension rights will need to be paid out for an increasingly long time. This will necessarily lead to pension levels gradually declining in relation to average pay, i.e. there will be a decrease in the remuneration rate.

In our opinion, an increase in retirement age is entirely necessary in order to maintain acceptable pension levels in the public pension system and public finances which are sustainable in the long term. It is essential to get people out of the habit of retiring at the age of 65. As a first step, pension rules and agreements should be amended so that retirement age increases by one month per year. The rules in the Employment Protection Act should also be revalued automatically by one month per year. Although this will probably not be enough to maintain current remuneration levels in the public pension system, it would help to provide more reasonable future pensions and ensure sustainable public finances.

5 A change in the surplus target

In section 5.1, we discuss why the target has been formulated in this way, and in section 5.3 we discuss how net lending is distributed among the various elements of general government. Short and long-term consequences of lifting the pension system out of the target are discussed in section 5.4.

5.1 The target includes the entire public sector

The current surplus target includes net lending in the consolidated public sector, i.e. the sum of central government net lending, the local government sector and the old-age pension system, eliminating transactions between sectors. The formulation of the target was discussed in a number of bills in the mid-1990s; and essentially the target took on its current structure with BP97, when the expenditure ceiling also took on its current form. The surplus target has undergone certain changes since then. From the outset, both a target for the average over an economic cycle and annual targets were set. The level for the target was 2 per cent of GDP, but as a consequence of Eurostat's decision not to include premium pensions in general government – but to include them in the private sector instead – the target was reduced to 1 per cent in the spring of 2007. However, the fundamental principle of the surplus target including the entire public sector has not changed since the target was introduced. That said, the argument as to why the target should include the entire public sector was not particularly detailed in the bills. Rather, the fact that it would be best to allow the target to include the entire public sector was taken as read.

When the target was formulated, Sweden was still heading for the end of the budgetary consolidation of the 1990s. One of many changes that took place at that time included making the central government budget comprehensive; this was also incorporated in the new Budget Act (budgetlagen). This must be viewed in respect of the fact that there had been a number of extra-budgetary funds such as the labour market fund, the wage guarantee fund and the health insurance fund, whereby the surpluses or deficits were not included in the budget balance itself even if they were part of the

Government's borrowing requirements. As some of these funds were very large, this meant that the budget balance did not provide accurate information. Including the funds in the central government budget so that the budget balance and borrowing requirements were the same thing was thus an initiative which aimed to make the budget more transparent, improving control over central government finances. Correspondingly, there were good arguments in respect of transparency and control, to include the entire public sector and surplus target.

Sweden had also recently joined the EU and signed the Stability and Growth Pact, which included targets for the consolidated public sector. Applying the same definition for the domestic target made the link to the EU's rules clear and logical, not least given the fact that Sweden's savings targets for the first few years were set so that we would gradually adapt to the requirements of the Stability Pact.

It is also important to bear in mind that the pension system reform was not complete at the time when the target was formulated for public finances. The pension reforms were ongoing, but the system had not taken on its present structure. In other words, there was no financially independent pension system as we know it today. However, it was known even at this time that net lending in the pension system could vary and that the demographic burden on the pension system would increase. However, this was deemed to be well into the future and could be dealt with by means of changes to the level of the surplus target. Combined with the fact that experience of the new pension system was very limited, there were overwhelming reasons to include the pension system in the surplus target.

5.2 Evaluation of the surplus target, 2010

The Government evaluated the surplus target in 2010, discussing at the time the issue of which sectors the target should include.[1] The Commission was of the opinion that there were arguments for lifting the pension system out of the target, but the overall view was that the arguments for retaining the current system were more persuasive. The primary reason for this was the fact that the Commission was of

[1] Ministry of Finance (2010).

the opinion that there was doubt as to whether the pension system could be regarded as autonomous in practice. The prevailing economic crisis at that time had resulted in the balancing mechanism in the pension system being activated for the first time, which had resulted in lower pensions. This had led to a political debate on how – rather than whether – pensioners should receive compensation. The Commission was of the opinion that few people advocated abandoning the automatic balancing, but according to analysts the debate nevertheless showed that there were political difficulties with allowing balancing to make full impact.

The Fiscal Policy Council discussed the issue in its 2008 report, and was of the opinion that the arguments in favour of excluding the pension system were not strong enough to justify changes to the regulations.[2] The Council came back to the issue in its 2010 report and arrived at the same opinion, which at that time also coincided with the opinion of the Commission.[3]

However, in its statement on the 2010 investigation, the Swedish Pensions Agency (PM) was of the opinion that the arguments for excluding the pension system from the surplus target were rejected far too readily. They wrote:

> *When net lending in the old-age pension system varies as a natural consequence of demographic and economic variants, central government and the local government sector are forced to act as buffers via a fixed surplus target, which in certain situations may jeopardise compliance with the stabilisation policy targets, for example. When it comes to a choice between excluding the income pension system from the surplus target and allowing this system's net lending to influence the level of the surplus target, the Swedish Pensions Agency is of the opinion that the former is preferable.*[4]

In other words, the Swedish Pensions Agency was of the opinion that pension system ought to be lifted out of the surplus target.

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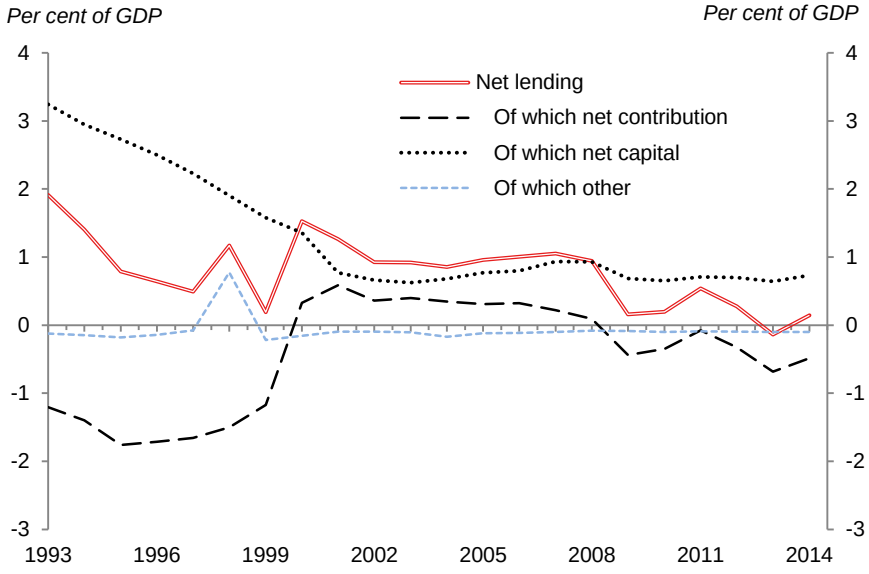
[2] Fiscal Policy Council (2008), section 2.3.3.
[3] Fiscal Policy Council (2010), section 4.1.
[4] Swedish Pensions Agency (2010).

5.3 Net lending distribution in general government

The local government sector has a balanced budget requirement. This means that municipalities must present a balanced budget, and if a municipality presents a deficit, this must be corrected within a period of three years. Net lending in the local government sector as a whole has been close to zero ever since the surplus target came into force. As a result, the local government sector has not contributed to variations in general government net lending.

Net lending in the pension system, however, has changed considerably throughout the same period. Ignoring the major transfers which took place from the pension system to central government between 1999 and 2001, the old-age pension system until 2008 presented a significant and fairly stable surplus of approximately 1 per cent of GDP (Figure 5.1).

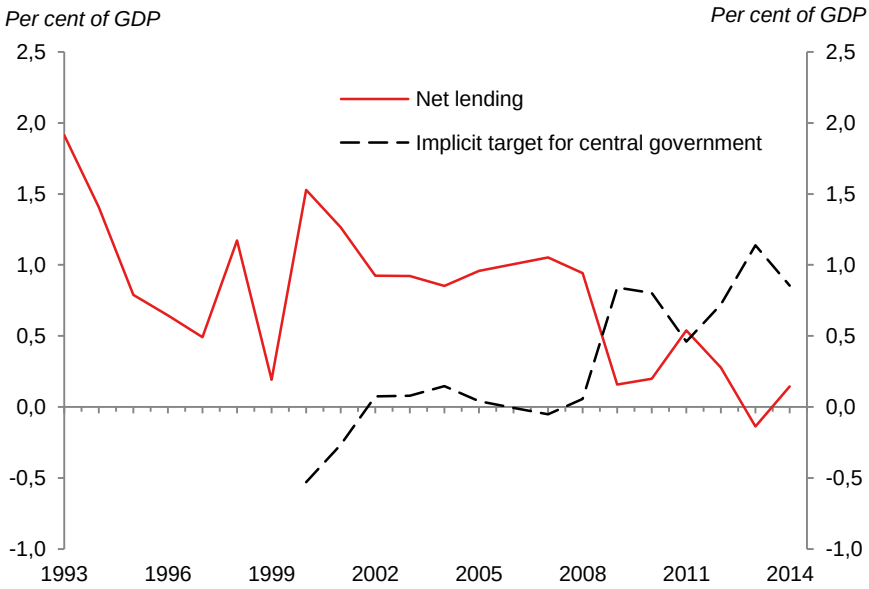
Figure 5.1 Net lending in the old age pension system per sub-item, 1993–2014



Note: As a consequence of the old-age pension reform, three non-recurring transfers took place from the old-age pension system to central government (equivalent to SEK 45, 45 and 155 billion) between 1999 and 2001, which involved temporarily lower net lending in the old-age pension system. Net lending in the figure above is shown exclusive of these transfers.
Sources: National Institute of Economic Research (2015c) and own calculations.

As the surplus target is also 1 per cent of GDP, this meant that net lending in the pension system until 2008 was sufficient to reach the surplus target even if central government net lending was equal to zero. This could also be expressed by saying that the surplus target for general government, in combination with net lending in the pension system in practice throughout that period, involved an implicit balance target for central government (Figure 5.2). Net lending in the pension system has gradually declined towards zero since 2008, and the implicit net lending target for central government has thus increased to around 1 per cent of GDP.

Figure 5.2 Net lending in the old age pension system and implicit target for central government, given a 1 per cent general government surplus



Note: As a consequence of the old-age pension reform, three non-recurring transfers took place from the old-age pension system to central government (equivalent to SEK 45, 45 and 155 billion) between 1999 and 2001, which involved temporarily lower net lending in the old-age pension system. Net lending in the figure above is shown exclusive of these transfers. Net lending in the local government sector is assumed to be zero in the calculation of the implicit target for central government.
Sources: National Institute of Economic Research (2015c) and own calculations.

To summarise, we can state that as long as net lending in the pension system remains more or less constant over time, the current structure of the surplus target means that the implicit net lending target for central government will also remain constant. If the level of the

surplus target takes into account net lending in the pension system to an appropriate extent, including the pension system in the surplus target will not present problems. If, on the other hand, net lending in the pension system varies, this will raise questions on the consequences which this is to be permitted to have for central government net lending. With the current surplus target, the implicit net lending target for central government is changed on a one-to-one basis, but with the opposite sign when net lending in the pension system is changed. If net lending in the pension system increases by one per cent of GDP, the implicit net lending target for central government is reduced by an equal amount. Reduced net lending in the pension system means that central government net lending needs to increase by a corresponding amount in order to meet the surplus target.

5.4 A surplus target with no pension system

Whether the pension system is to be included in the surplus target has been discussed several times before, as stated above. To date, it has been concluded that there are no compelling reasons to change the structure of the present target. In particular, it has been argued that the pension system is not fully autonomous, and that this indicates that it should be included in the surplus target. We are of the opinion that there are good reasons to review the structure of the surplus target.

5.4.1 The pension system is mechanically robust – but perhaps not politically robust

The pension system is structured in a manner which makes it financially sustainable in the long term. If the anticipated future outbound payments are greater than can be financed with future charges and the capital in the AP Funds, the level of pensions will be adapted automatically so that the system maintains long-term equilibrium between income and expenditure. However, long-term sustainability does not mean that income and expenditure have to balance every year. Temporary demographic changes will result in sometimes negative and sometimes positive net lending. The AP Funds are buffers which are used to manage these variations. In

other words, the fact that the pension system occasionally exhibits negative net lending is nothing which in itself indicates a crisis in the system or gives reason to change the fiscal stance. A deficit in the pension system does not mean a need for increased central government net lending, any more than higher net lending in the pension system creates scope for tax reductions or central government spending increases.

One recurring argument in favour of including the pension system's net lending in the surplus target is that responsibility for a crisis in the pension system rests ultimately with the Government. If the pension system is unable to deliver pensions which are perceived as acceptable, political demands will be made for costly changes; either in the form of changes to the pension system itself, or as some form of compensation from central government. Therefore, responsible fiscal policy must carefully monitor the development of the pension system.

In the short term, the political risk is related to the pension system's balancing mechanism, known as the brake, which means that the upward adjustment of pension levels is reduced if anticipated pension payments are estimated to be greater than the sum of the anticipated charges and the value of the AP Funds. This mechanism was activated in connection with the financial crisis, partly due to negative value changes in the shareholdings of the AP Funds.[5] This led to demands for action in order to compensate at least in part for pensioners' loss of income. Irrespective of whether or not such compensation is warranted, it is likely that an activated brake may lead to similar compensation demands in the future as well.

[5] Such value changes are outside measured net lending and so are not the cause of the fall in net lending in the pension system since 2008. Figure 5.1 indicates that the cause of the decline in net lending in the pension system from 2008 onwards is essentially not due to net capital, but to the difference between contributions paid in and pensions paid out, i.e. the net contribution.

Box 5.1 The balancing mechanism

The pension system has an automatic balancing mechanism which ensures that the money in the system does not run out. Each year, what is known as a balance ratio is calculated by dividing the assets in the pension system by its liabilities. The assets consist of estimated future income from contributions and the buffer fund, i.e. the market value of the First to Fourth AP Funds and the Sixth AP Fund. The liabilities consist of all estimated future pension payments. If this ratio is less than 1, the liabilities are greater than the assets. Pensions are indexed by means of an income index in normal cases, but if the balance ratio is less than 1, what is known as a balance index is used instead which then provides a lower upward adjustment rate. This is sometimes referred to as the brake being activated and it may involve pensions being adjusted upwards at a lower pace, but also reduction of pensions. When the balance ratio has become positive again, pensions are adjusted upwards at a faster pace until they have caught up and reach the level which they would have achieved had balancing not taken place.

The fiscal framework is helping to force a debate into the political priorities which the Government and Riksdag wish to set. Increased spending or falling tax revenues must not automatically lead to deficits, but must be managed by the political system with the assistance of the fiscal framework. Measures which compensate for lower pensions affect central government net lending, irrespective of whether the pension system's financial net leading lies outside the surplus target or is included in the target. Thus the fact that the pension system is not necessarily politically stable in the short-term is not in itself an argument for keeping the pension system's net lending in the surplus target. It is important to be aware that the pension system's net lending is not what determines whether or not the brake is activated. Instead, this is determined by the long-term balance between future estimated income and expenditure. Therefore, it is entirely possible that the brake will be activated even if net lending is positive, or that it will not be activated even though net lending is negative.

As we discussed in chapter 4, there is a risk of the pension system being perceived as insufficient in the future, and that this will lead to

political pressure to compensate pensioners one way or another. In our opinion, there are no good arguments as to why central government net lending should vary in order to offset such temporary changes in the pension system's net lending. That said, it is not possible to rule out the pension system having to be reviewed politically in the long term due to it providing pension levels which are perceived as unreasonably low. However, questions relating to the long-term political sustainability of the pension system will not be resolved by including the pension system's net lending in the surplus target.

5.4.2 The local government sector and other net lending

Besides central government and the pension system, the surplus target also includes local government net lending. It could be argued that the local government sector is also independent and, in a formal sense, stable and autonomous in relation to central government, and that it therefore also ought to be lifted out of the surplus target. However, the arguments in favour of excluding local government are by no means as strong as for the pension system. Local government is subject to a balanced budget requirement, and so no significant surplus or deficit may occur. If a deficit nevertheless occurs, this probably – unlike a deficit in the pension system – indicates problems which may demand central government action. The fact that central government needs to increase its net lending when deficits occur within local government is therefore not so much a problem as a justified order.

Some elements of net lending comprise payments made to the Swedish Nuclear Waste Fund and the Deposit Guarantee Fund. These deposits reinforce central government net lending and are thus included in the surplus target. In other words, these deposits are not funded separately, but mean in practice that other income may be lower or expenditure higher than if the deposits have not been included in net lending. That said, these deposits correspond to commitments from central government for the deposit guarantee and for expenses for the storage of nuclear waste. Such commitments should be considered when assessing an appropriate level for net lending.

Central government also borrows significant amounts and lends these out to the Riksbank and to students via the National Board of Student Aid. This borrowing does not affect net lending directly, but means an increase in both central government debt and gross government debt. This should also be taken into account when considering the level for net lending.

One important argument for lifting the pension system out of the surplus target is that variations in net lending lead to unjustified changes in central government net lending. However, this problem is not applicable to local government net lending, provisions to funds or central government lending, and so there are no corresponding arguments for lifting these elements out of the surplus target as well. However, the level for the target for central government net lending – irrespective of whether it is explicit or implicit – should take these factors into consideration.

5.4.3 Uncertainty regarding central government net lending in the long term

In our 2014 report, we argued that the development trajectories for central government net wealth and gross debt are central when it comes to assessing an appropriate level for the surplus target. We noted that subject to reasonable assumptions, the ratio of net wealth in the form of interest-bearing assets to GDP will converge towards a level provided by the surplus target level divided by the nominal growth rate in GDP.[6] If, for example, the surplus target of 1 per cent of GDP is achieved and the nominal GDP growth rate is 4 per cent per year, net wealth will converge towards 25 per cent of GDP, while a balance target will lead to the net wealth converging towards zero.

The level towards which the net wealth ratio converges refers to that part of general government covered by the surplus target. Therefore, selecting a level for the target must take into account the way in which the surplus target is formulated. With the present

[6] The central assumption here is that the value increase of non-interest-bearing assets (shares) corresponds to the rate of GDP increase and that the part of general government to which the surplus target relates does not buy or sell such assets net. Although this is not necessarily the best assumption for the policies of all governments, it is a natural starting point for reasoning concerning the consequence of the surplus target for the development of gross debt and net wealth. See Fiscal Policy Council (2014b) for a more detailed discussion.

surplus target, net wealth in interest-bearing assets converges at 25 per cent of GDP for central government, local government and the pension system combined.[7] As we can disregard local government net lending, therefore, the net wealth of central government in interest-bearing assets will converge towards 25 per cent of GDP minus the interest-bearing wealth generated by net lending in the pension system.[8] This is because central government wealth is generated by central government net lending, which, with the present target formulation, is provided by the surplus target level minus pension system net lending.

We were of the opinion in 2014 that there were overwhelming grounds for retaining the present level of the surplus target for general government. This was based on the assumption that net lending in the pension system would be positive in the long term so that the size of the AP Funds would roughly follow the development of GDP. This in turn was based on the projections of net lending in the pension system which were made at that time and presented in last year's report. Such a development would mean that the implicit net lending target for central government would remain near to zero, i.e. that the surplus target in the long term would correspond approximately to a balance target for central government. Thus central government gross debt would be expected to fall slightly over time but not disappear. In the long term, central government debt would move towards a position of equilibrium corresponding to central government lending, primarily in the form of National Board of Student Aid loans and loans to the Riksbank, which currently amount to approximately 10 per cent of GDP. A development pointing towards long-term central government debt in the order of 10 per cent of GDP is very ambitious from an international perspective and provides major scope for fiscal measures. A lower net lending target would be consistent with sustainable development, but the margins would be reduced. The chances of financing potential major conversion of Sweden's energy supply in future through borrowing, for example, would be reduced if central

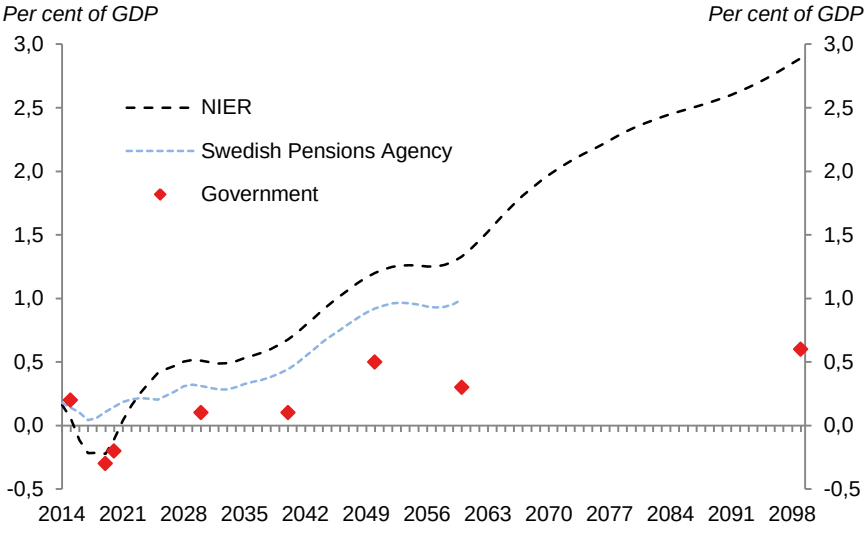
[7] We assume here that the surplus target is attained.

[8] Central government gross wealth in interest-bearing assets equals net wealth minus lending (primarily to the Riksbank and via the National Board of Student Aid, which currently constitutes approximately 10 per cent of GDP).

government borrowing were to increase at present. Therefore, we perceive no convincing reasons for changing our opinion, that a net lending target leading to approximately 10 per cent central government debt is currently reasonable for central government in the long-term.

However, there are various forecasts for net lending in the pension system which point in a radically different direction. So in practice, it is unclear as to which net lending target for central government, and hence what development of central government net wealth, will follow on from a specific net lending target for general government. Moreover, the long-term and short-term forecasts are not consistent. Figure 5.3 shows three long-term forecasts for net lending created by the Government, NIER and the Swedish Pensions Agency. According to the Government, net lending is estimated to stand at approximately 0.5 per cent of GDP in the long term, while NIER and the Swedish Pensions Agency are expecting to see net lending gradually increase towards significantly higher levels.

Figure 5.3 Forecasts for net lending in the old-age pension system, 2014–2099



Sources: National Institute of Economic Research (2015a), confidential estimates from the Swedish Pensions Agency (2015) and the Ministry of Finance (2015d).

Working on the basis of the NIER and Swedish Pensions Agency forecasts, a balance target for the entire public sector would involve a significant deficit in central government net lending. This, together with other lending would have to be financed with increasing central government debt. According to NIER forecasts, the surplus target of 1 per cent would lead to a deficit in central government net lending in the long term. The Government's forecasts concerning the pension system instead mean that central government net lending must demonstrate a surplus in order to meet the present surplus target for general government, which would involve central government debt being eliminated. In other words, there is significant uncertainty regarding pension system net lending in the long term, and this is spilling over into uncertainty regarding the development of central government debt. Of course, there is reason to examine why these forecasts differ so widely. Robust analyses are significant in order to assess the sustainability of the pension system.

5.4.4 The EU's budget rules

The EU's Stability and Growth Pact includes requirements stating that the deficit in the consolidated public sector must not exceed 3 per cent of GDP and a Medium-Term Budgetary Objective (MTO), which as far as Sweden is concerned means that cyclically adjusted net lending must not normally be lower than -1 per cent of GDP. In its 2012 report, the Fiscal Policy Council discussed the relationship between the EU's rules and the Swedish fiscal framework. It was concluded that the Swedish framework is more flexible in that the surplus target is formulated for an economic cycle without specifying rules for net lending for individual years. The Swedish framework is also more ambitious as regards long-term public net wealth, and is also supported by other rules such as – for example – the expenditure ceilings and framework model for budget decisions.

At present, both Sweden and the EU use targets relating to the entire public sector. If Sweden were to exclude the pension system from the surplus target, this would reduce the direct comparability between targets. This is sometimes used as an argument in favour of not changing the restriction of the surplus target. However, it is currently already the case that the two regulatory systems have to be managed in parallel, and following the Swedish framework does not

automatically mean that there is also compliance with the EU's budget rules. The flexibility provided by the surplus target by being formulated as an average over an economic cycle permits deficits which may be greater than 3 per cent of GDP in individual years and structural deficits which are greater than 1 per cent of GDP.[9] The EU's rules stating that gross government debt must not exceed 60 per cent of GDP are not supported in the national framework either. The EU also has what is known as an expenditure criterion which sets limits with regard to how much government spending may increase when a country deviates from its MTO. This has no direct link with the national framework either.

The fact that the national framework does not match the EU framework is not unique, either. A number of EU countries have different types of national fiscal rules which are not the same as the rules applicable at EU level in terms of either form or content.[10] Lifting the pension system out of the surplus target certainly means that Sweden's national net lending target would have a different restriction to that applied in the Stability and Growth Pact, but in our opinion this is not a decisive argument in respect of how the Swedish surplus target should be formulated.

5.4.5 A shorter perspective

As we discussed previously, net lending in the pension system can be expected to deviate occasionally from the historical average. Net lending in the pension system has fallen sharply over the last few years and is now close to zero. Until 2018, this reduction – according to the Swedish Pensions Agency – is expected to continue down to approximately -0.4 per cent of GDP, a level at which net lending is

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[9] In its convergence programme for 2015, the Government writes (Ministry of Finance, 2015c, p. 10) that if the surplus target is reached, the requirements of the Stability and Growth Pact will also be met, and that this will apply even if the surplus target were to be reduced to zero. However, the Council is of the opinion that the surplus target does not guarantee that Sweden will meet its medium-term budgetary objective, particularly not if it were to be reduced to zero. Both regulations must be followed in parallel. As Sweden is currently meeting its MTO and government finances are gradually improving, however, there is no acute risk of Sweden breaching the EU's budgetary rules. In a footnote to the convergence programme, the Government points out that the surplus target means that it is "highly likely" that the EU's requirements will be met.

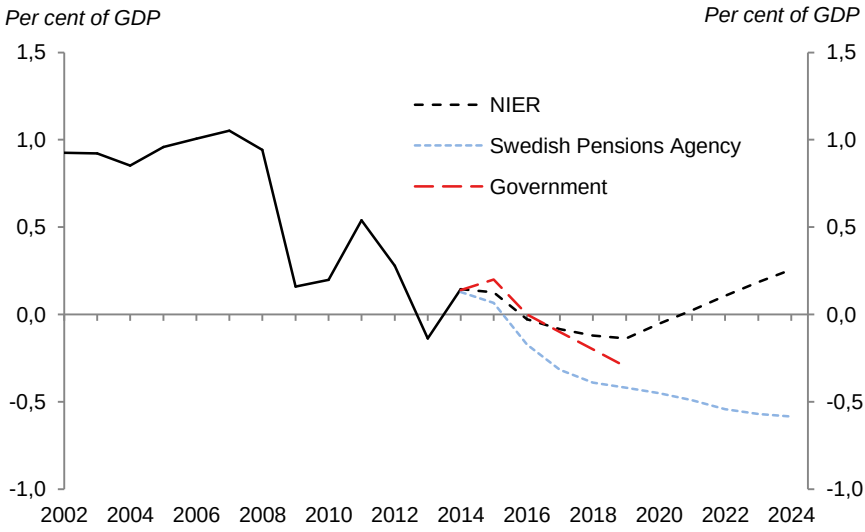
[10] The IMF (2013) has compiled a list of fiscal rules in a large number of countries which includes both national rules and international commitments.

expected to remain for a number of years. The reduction since 2008 is thus equivalent to approximately 1.5 per cent of GDP (Figure 5.4).

The declining net lending in the pension system means that central government net lending must be increased from the previous level of zero to approximately 1.5 per cent of GDP, which means tightening up central government's implicit net lending target by more than SEK 50 billion. However, this is merely a reflection of variations in net lending in the pension system. We are not of the opinion that such an increase in central government's implicit net lending target is justified.

Setting central government's implicit net lending target to zero or 1.5 per cent of GDP is of significance to the formulation of fiscal policy. The present target makes great demands for austerity measures towards the end of the current mandate period than if the implicit balance target for central government were to continue to apply. In our opinion, both the present target and a balance target for central government can be achieved by 2018 without unacceptably large problems relating to stabilisation policy.

Figure 5.4 Forecasts for net lending in the old-age pension system, 2014–2024



Note: Government forecasts in VP15 are provided only to the end of 2019.
Sources: National Institute of Economic Research (2015c), confidential estimates from the Swedish Pensions Agency (2015) and VP15.

5.5 Government plans for a balance target

On 3 March, the Government announced at a press conference that it was intending to task NIER with investigating the consequences of changing the level of the current target from a 1 per cent surplus to zero on average over an economic cycle.[11]

The Council discussed the level of surplus target in its 2014 report and did not recommend at that time that the target should be reduced.[12] However, this was not due to the fact that the Council was of the opinion that a reduction in a balance target would lead to unsustainable public finances. Instead, calculations showed that a balance target was probably compatible with both sustainable public finances and sufficient buffers for stabilisation policy. However, there were other arguments which played a part in the opinion of the Council, and given the fact that the Government is considering switching to a balance target, there is reason to repeat these.

We have criticised in a number of reports the fact that the following up of the surplus target is not sufficiently clear. A target relating to an economic cycle must in itself be evaluated with regard to the economic situation, and there is no easy way to do this. Even so, our opinion is that it ought to be possible to make the follow-up more stringent and to have clearer criteria as to whether or not there is deviation from the target. The Budget Act states that the Government must describe how a return to the surplus target is to take place if a deviation is deemed to exist.[13] This assumes that it is possible to identify fairly clearly whether a deviation exists. The Council, like a number of other analysts, was of the opinion that there was a clear deviation from the surplus target in the spring of 2014. However, the Government of that time claimed the opposite. In other words, the follow-up of the target left plenty of scope for interpretation.

The lack of clear criteria concerning how the target is to be followed up has, in the opinion of the Council, contributed to the drift from the surplus target that has taken place. With a lower target for net lending, there is a risk that the consequences of failing to

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[11] NIER was given until 14 August 2015 to report on its results.
[12] Fiscal Policy Council (2014b), chapter 7.
[13] SFS 2011:203, Chap. 2, section 1a.

achieve the target will be more serious, in the form of both poorer long-term development and smaller margins to the limits set by the EU's budgetary rules. Therefore, we wrote in our 2014 report that if the target were reduced, it should be combined with changes to the framework that improve the chances of meeting the target in the future. Therefore, it is important to combine the planned reduction in the surplus target with measures for reinforcing the follow-up.

According to the latest forecasts from the Government, net lending is estimated to be strengthened gradually from -1.9 per cent in 2014 to -0.1 per cent of GDP in 2018, when the economic situation is forecast to be in equilibrium. These calculations are based on respect for the principle whereby all reforms must be fully financed. Judging by the estimates in VP15, therefore, the "krona-for-krona" policy rule will lead to equilibrium in public finances when the economic gap is closed. Thus "krona-for-krona" would be sufficiently tight to meet a balance target for general government, but not to achieve the current surplus target. The principal whereby all reforms must be fully financed was included in BP15, and the same principle remains unchanged and is applied in VP15. In other words, the fiscal policy rule is as tight as it was before. Thus the transition to a balance target would not provide any increased scope for fiscal measures over the next few years, as is also stated by the Government in VP15.[14]

In the slightly longer term, a reduced surplus target ought to result in scope for higher expenditure or lower taxes by 1 per cent of GDP, or approximately SEK 40 billion per year. However, this is based on the surplus target actually being achieved prior to the reduction. If net lending was too low in relation to the surplus target of 1 per cent, the reduction to a balance target will be less than SEK 40 billion in practice. The difference between the current situation in which we are not achieving the surplus target – or, as the Government writes, are clearly deviating from the target – and complying with a balance target is reasonably less than 1 per cent of GDP.

In the long term, 15–20 years, the scope is limited by the fact that a lower net lending target will lead to stabilisation of central government debt at a higher level than would otherwise have been

[14] VP15, p. 39.

the case, which in turn will lead to a higher level of interest payments. Under reasonable calculation criteria, the increase in scope provided by a lower net lending target will be cancelled out by higher interest payments as a consequence of greater central government debt.[15] In the long term, therefore, a lower net lending target will not lead to greater scope for fiscal measures.

A transition from a surplus target of 1 per cent of GDP to a balance target thus involves a certain increase in scope for fiscal measures, but this will not be a dramatic or immediate increase. The increase in scope manifests itself in less need for austerity in the short term compared with what would happen if the policy were to aim to achieve 1 per cent, and a certain increase in scope for a transitional period thereafter. The fact that a transition to a balance target will not involve a major increase in fiscal scope is also illustrated by how Sweden is meeting its Medium-Term Budgetary Objective (MTO) in the Stability and Growth Pact. This target means that Sweden must not normally have structural net lending weaker than -1 per cent of GDP. According to the EU Commission's winter forecast[16], Sweden's structural net lending in 2014 was estimated at -1.3 per cent of GDP, but Sweden was deemed to meet the requirement even so as net lending is improving at a satisfactory pace. Thus the margins for the commitments within the EU are limited and a transition to a balance target will create no scope in this respect.

In this chapter, we have argued in favour of changing the restriction of the surplus target by lifting out the old-age pension system. Like a transition to a balance target for the entire public sector, this would create a certain increase in fiscal scope compared with a policy which aims to achieve the current surplus target.

How a potential transition from a surplus target to a balance target is justified is important. Demographic development means that net lending in the pension system has weakened since 2008 and will probably remain negative throughout the next decade. The surplus target largely used to be met thanks to the surplus in the pension system. With weaker net lending in the pension system in future, therefore, central government net lending will need to be higher in order to meet the surplus target. We are of the opinion that

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[15] Fiscal Policy Council (2014b), chapter 7.
[16] European Commission (2015b).

tightening up central government net lending in this way is not justified. Instead, the reduced net lending in the pension system gives cause to review the structure of the surplus target.

That said, we are critical of stabilisation policy arguments for reducing the surplus target. As stated in section 2.4, there is reason to doubt that general stimulation of demand would be desirable as things stand at present. There is also reason to challenge the perception that major socio-economically viable infrastructure investments exist which can and should be implemented in the near future (see chapter 6). Moreover, changing to a balance target as discussed above does not involve any increase in scope in the short term. The Council is of the opinion that from a stabilisation policy angle, it would not have been unreasonable to return to a 1 per cent surplus by 2018, and it is important for stabilisation policy not to become a main argument for changing the surplus target. Recouping deficits will always be costly, both economically and politically, and this is true irrespective of whether the target level is surplus or balance. As we also wrote in last year's report, this is why it is important for a change in target not to be perceived as a result of a lack of willingness or ability to maintain the established target.

We would also like to point out what the Council wrote in its statement on the Government's assessment of the surplus target (Ds 2010:4). At that time, the Council was of the opinion that it was not possible to say with any great degree of certainty exactly what target level is most appropriate. That said, the very existence of a target for net lending is probably of major significance. Both experience and research indicate that there is a strong tendency in fiscal policy to allow short-term considerations to dominate more long-term issues, thus leading to substantial accumulation of debt. Such tendencies are counteracted by clear balance targets. For the target to be credible and stable, it has to have wide political support and the follow-up and reporting of the target must be characterised by clarity and transparency. These issues are every bit as important as – or perhaps even more important than – the exact level of the target.

We are of the opinion that there are advantages with changing the definition of the target and lifting out the pension system rather than reducing the level of the target. Excluding the pension system would eliminate changes to central government's implicit net lending target, which is due to the fact that net lending in the pension system varies.

Changing the definition of the surplus target in itself is a slightly more complex measure than changing its level, as the Budget Act would probably need to be amended in this case.[17] At the same time, we are of the opinion that there is a need for a broader analysis of the surplus target which also considers issues such as the restriction of the target and how the target ought to be followed up, for example.

It is also important for the broad political consensus concerning the fiscal framework to be maintained. There are currently three committees which will be working with issues relating to the fiscal framework: an assignment allocated to NIER which must be completed in August 2015, an announcement stating that the Government ought to set up a Parliamentary enquiry[18], and a commitment in the December Agreement to investigate issues relating to the budget process. The chances of analysing a number of sides of the fiscal framework ought to be good.

5.6 Assessments and recommendations

The pension system is formulated to be financially sustainable. However, net lending in the pension system may vary without this presenting a problem in terms of sustainability. As the surplus target relates to general government in its entirety, however, variations caused by the pension system must be compensated by variations in central government or local government net lending. This may in turn create unwanted effects for the stabilisation policy, and for the development of central government debt in the long term. We are of the opinion that there are good reasons for considering lifting the pension system out of the surplus target.

The pension system's net lending is close to zero at present, and there is a consistent opinion that this will fall in future and be negative during the present and next mandate period. With a surplus target for general government in its entirety which is fixed at 1 per cent, this means that the implicit net lending target for central government will increase by almost 1.5 percentage points in relation

[17] The Budget Act (SFS 2011:203), chapter 2, section 1, states that the Government must submit proposals to the Riksdag concerning targets for general government net lending.
[18] Bet. 2014/15:FiU30.

to the figures applicable until 2008. In our opinion, such an increase is not justified.

In our 2014 report, we arrived at the opinion that the present surplus target of 1 per cent of GDP ought to remain in place until further notice. This analysis was based on the assessment that a surplus target of 1 per cent in the long term would lead to an implicit balance target for central government. Central government net wealth in interest-bearing assets will then converge towards zero. Gross debt will not disappear but will correspond to the value of central government claims on the Riksbank, repayments of student loans and other assets such as the Swedish Nuclear Waste Fund. We are of the opinion that the assessment of a surplus target level appropriate in the long term which was made at that time is still reasonable.

However, there is significant uncertainty concerning the long-term development of the pension system's net lending, which is a significant argument for excluding the pension system from the surplus target. If the pension system were to be lifted out, in our opinion it would reasonable to maintain the implicit balance target for central government previously inherent in the current surplus target. Nor do we see any convincing arguments for departing from this implicit target for central government net lending in the shorter term. If the pension system is excluded, therefore, central government net lending target being zero – a balance target for central government – is a reasonable starting point.

One alternative to lifting out the pension system would be to change the level of the target as net lending varies in the pension system. However, this would involve a risk of reducing the stability and credibility of the target. A system in which the level of the target is appraised infrequently but regularly in an orderly fashion – every ten years, for instance – would help to give the target a certain degree of flexibility without harming its long-term credibility. However, it is important for any changes to the level of the target to be based on long-term considerations and not on short-term reasons relating to stabilisation policy.

The Government announced on 3 March this year that it was intending to reduce the surplus target to a balance target and that NIER would be tasked with investigating a change of this type. We are of the opinion that there are good reasons to review this target

and that the sustainability of public finances will permit lower net lending than the present surplus target. Two additional investigations have been announced in addition to the task assigned to NIER; one at the initiative of the Riksdag and one via the December Agreement. There ought to be a good chance of implementing comprehensive illumination of the surplus target and other parts of the framework.

6 Infrastructure decisions and socio-economic profitability

Chapter 6 discusses investment in transport infrastructure, i.e. investments in and maintenance of roads and railways. In section 6.1, we attempt to find answers to the question of whether there is insufficient investment in roads and railways. Section 6.2 analyses the effectiveness of the Government's decisions on infrastructure issues. Section 6.3 summarises the Council's assessments and recommendations.

6.1 Are investments too low?

In previous reports, we have discussed various aspects of public investments.[1] We compiled a summary of investments and general government capital stock in our 2009 report. We found no strong evidence indicating that central government investments would have been neglected. That said, we did find indications that there may be a need to increase local government investments in future. Our most severe criticism related to the lack of satisfactory statistical data: the statistics were so flawed that the conclusions we were able to draw at that time were very uncertain. We were of the opinion that the Government had focused far too little interest in the field up to this point and concluded that a consequence of this was that the Riksdag had not received satisfactory decision data.

In VP12, the Government published an appendix which included a detailed description of public sector investments, capital stock and real wealth. Since then, the Government has described general government investments and capital stock each year in a separate appendix to the Spring Fiscal Policy Bill. The Council is of the opinion that it is good that the Government is regularly reporting statistics and analytical considerations in this way. In these appendices, the then Government stated that public investments are not neglected if we compare the situation in Sweden with other countries. At the same time, it emphasised that it is difficult to assess

[1] See Fiscal Policy Council (2008–2012).

what constitutes an optimum investment level. We agree with the then Government as regards both of these conclusions.

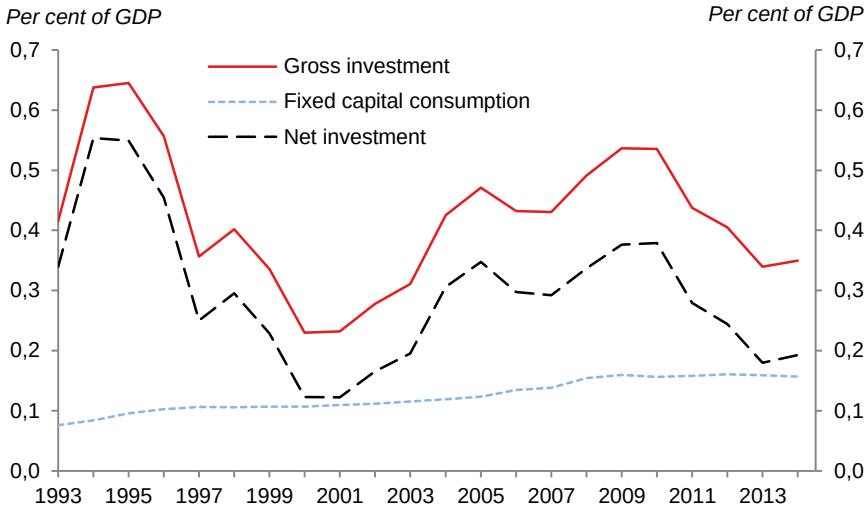
The present Government also has an appendix to the Spring Fiscal Policy Bill which describes investments and capital stock in the Swedish economy, focusing in particular on general government. This appendix also highlights investments in homes this year, which is good. The Government emphasises in the appendix the importance of giving priority to each investment project on the basis of their anticipated socio-economic returns. We will return to this issue in section 6.2.

6.1.1 Investments in roads and railways

Figure 6.1 below shows how gross investments, fixed capital consumption and net investments in railways have developed between 1993 and 2014. In the mid-1990s, gross investments in railways were considerably greater than their fixed capital consumption. Investments as a percentage of GDP fell towards the end of the millennium before then starting to climb again until around 2010, after which time they have fallen slightly.[2] Gross investments have been considerably greater than fixed capital consumption throughout this entire period, which means that net investments have been consistently positive. Capital stock in the form of railways has thus grown enormously.

[2] The downturn since 2010 is explained in part by the fact that the last stage of the Botniabanan Line (the Ådalsbanan Line) was completed at that time.

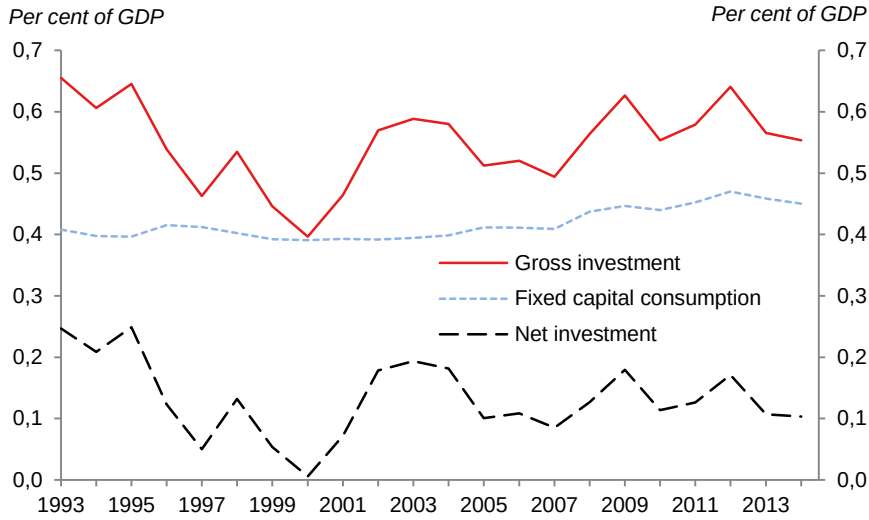
Figure 6.1 Investments in railways, 1993–2014



Note: Railway investments only take place within central government, not within the local government sector.
Source: VP15.

Figure 6.2 below shows gross investments, fixed capital consumption and net investments in the form of roads between 1993 and 2014. Gross investments in roads have not varied to the same extent as investments in railways, but have remained at approximately 0.6 per cent of GDP throughout the period. Despite the fact that gross investments in roads have been higher than gross investments in railways on average, net investments have been lower. This is due to the fact that fixed capital consumption for roads is considerably higher than for railways. Therefore, greater investments in roads are needed compared with railways in order to maintain a constant capital stock.

Figure 6.2 Investments in roads, 1993–2014



Note: Refers to both central government and local government investments.
Source: VP15.

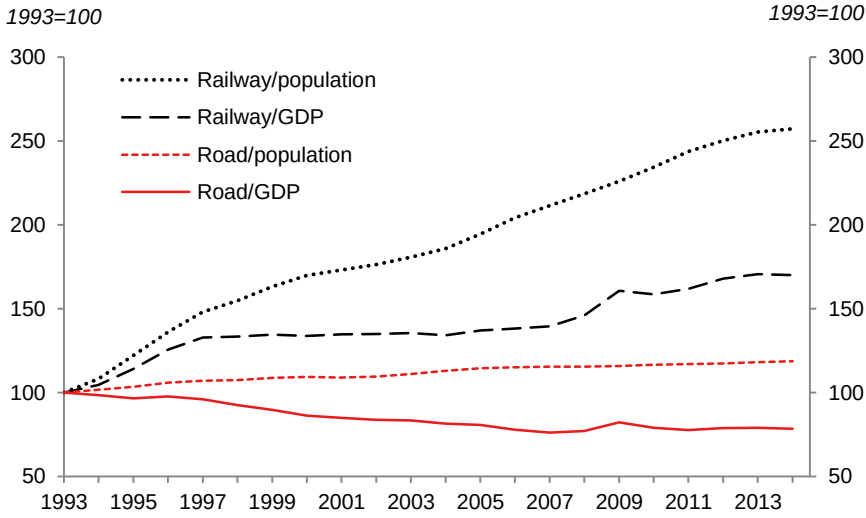
We can state that gross investments in roads and railways since 1993 have been sufficient to more than cover fixed capital consumption. Capital stock volume has grown as a result.

6.1.2 Capital stock of roads and railways

The infrastructure element of public capital stock is particularly important to economic growth. Transport-related capital accounts for the lion's share of infrastructure, and the road and rail networks are the most important elements.

Figure 6.3 shows how capital stock of roads and railways has developed as a percentage of GDP in constant prices, and in relation to the population.

Figure 6.3 Capital stock of roads and railways in relation to GDP and the population, 1993–2014



Note: Capital stock and GDP are calculated in constant prices. Index with base year 1993 = 100.
Source: Ministry of Finance (2015a).

Relating the capital stock of roads and railways to GDP in constant prices provides a view of development in relation to the total produced volume of goods and services in Sweden. GDP may increase both because the volume of goods and services produced is increased and because the quality of these is improved. The burden on the transport infrastructure may be assumed to increase if the volume of goods and services produced increases. That said, it is by no means obvious that the burden on the infrastructure will increase if the quality of the goods and services produced increases. However, it is not unreasonable to assume that improved quality will make more stringent demands of the reliability of the transport system.

Transport infrastructure is also used for a significant proportion of passenger transport. Hence it is relevant to relate the capital stock of roads and railways to the population.

The capital stock of railways in constant prices increased as a percentage of GDP as a consequence of major investments between 1993 and 1997. It developed in line with GDP in the years which followed. The capital stock of railways has increased slightly since the financial crisis and Euro crisis began. The capital stock of railways has more than doubled since 1993 in relation to the population.

The capital stock for roads fell constantly as a percentage of GDP between 1993 and 2007. It has remained largely unchanged since then. It has increased marginally in relation to the population since 1993.

Public debate sometimes claims that far too low an investment level in roads and railways has brought about gradual worsening of the transport infrastructure. The statistics we have presented here do not support this assumption. On the contrary: the investment budget for railways at least has been so great that railway capital per capita has more than doubled in two decades. Insofar as this strong growth is not perceived as satisfactory, it seems more logical to question whether railway investments have actually been made in the locations where they are needed, rather than claiming that the investment budget has been too parsimonious. In the next section, we will present clear examples indicating that investments have by no means been given priority in a socio-economically efficient way.

The maintenance and repair of roads and railways are crucial to ensure the efficient functioning of the road and rail networks.[3] Media reports of problems on the railways have increased over the last few years.[4] This makes people suspect that the maintenance and repair of tracks, points, railway embankments, etc. have been neglected. This view is underpinned by the information provided by the Government in BP15.[5] The Government claims that insufficient resources for the operation and maintenance of the railway system have been allocated "for many years".[6] However, it is not possible to assess on the basis of statistics and analyses presented by the Government whether insufficient resources have been available for the maintenance and repair of roads and railways. An enquiry presented recently states that knowledge of the rail network and its use is not available at "a level which permits appraisal of knowledge and assessment of the need for

[3] The central government appropriation framework for the planning period 2010–2021 amounted to SEK 417 billion in 2009 prices. Of this amount, SEK 200 billion was allocated for the operation and maintenance of national roads and railways (BP15, Ea 22, pp. 49–50). The framework for the currently applicable period, 2014–2025, amounts to SEK 522 billion in 2013 prices. Of this amount, SEK 241 billion was allocated for the operation and maintenance of national roads and railways (see Ministry of Enterprise, Energy and Communications, 2014).

[4] See, for example, Dagens Nyheter (2015).

[5] See BP15, Ea 22, p. 38.

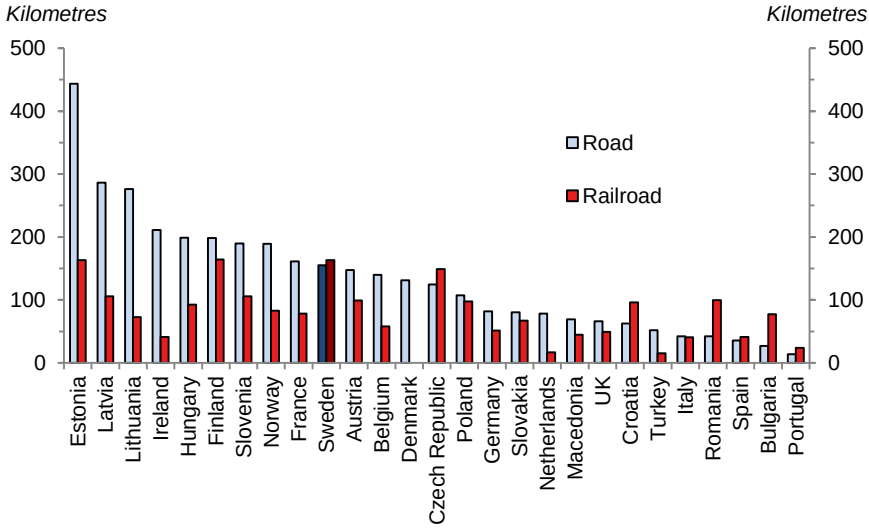
[6] BP15, Ea22, p. 61.

action".[7] The Council finds this to be highly remarkable. The Government should present a coherent analysis of the maintenance requirement for the Swedish road and rail network. Otherwise there is a significant risk of resources for maintenance and repairs not being used in the areas where they are most needed and therefore failing to resolve existing problems.

6.1.3 Investments in roads and railways from an international perspective

Figure 6.4 shows the road and rail network in relation to the population in the majority of European countries. This figure shows that in relation to the population, Sweden has one of the biggest rail networks in Europe. That said, a number of countries have a larger road network per inhabitant than Sweden.

Figure 6.4 Road and rail networks in relation to population



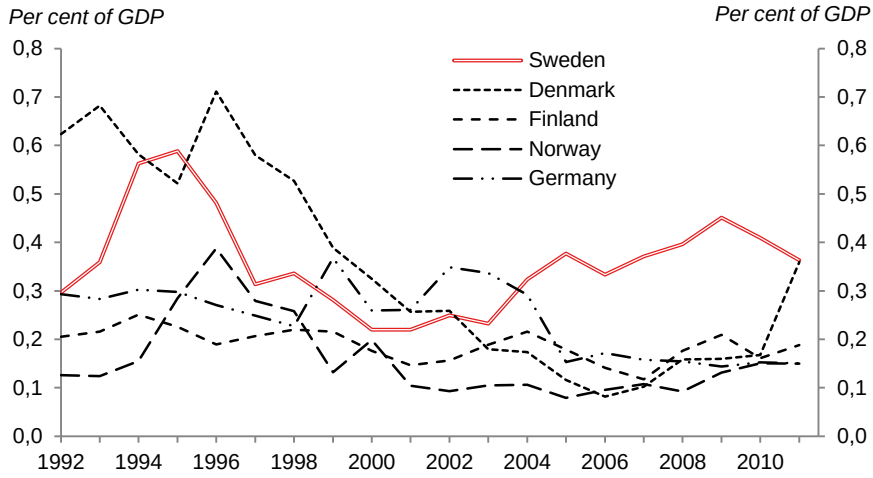
Note: Railways are specified in km per 100,000 inhabitants, and roads are specified in km per 10,000 inhabitants. Data relates to 2009–2012 for most countries, apart from railways in Ireland and roads in Denmark (2008). Germany's road network in 2011 is based on data from the World Bank as Eurostat does not have relevant data.
Source: Ministry of Finance (2015a).

[7] SOU 2015:42, p. 14.

In all, Figure 6.4 shows that Sweden has a relatively large road and rail network per inhabitant compared with other European countries.

If we consider how investments in railways have developed over time (Figure 6.5) in the Nordic countries and Germany, we can state that Sweden is relatively high.

Figure 6.5 Infrastructure investments in railways, 1992–2011

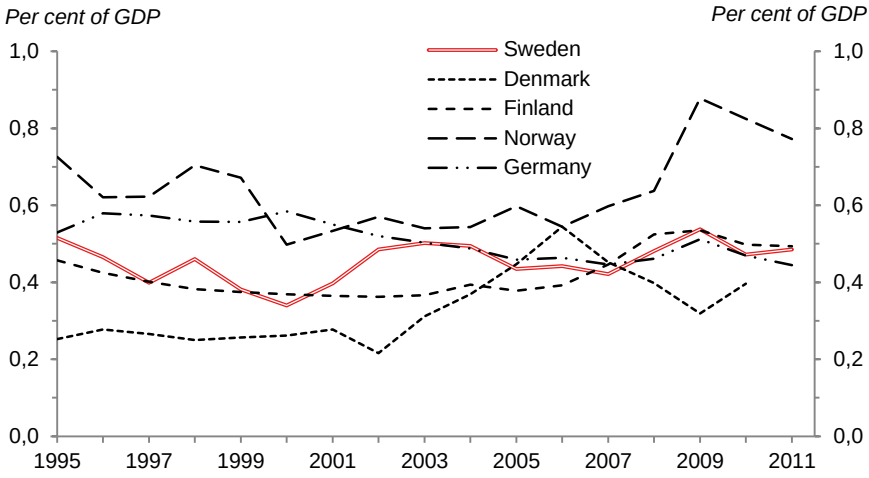


Source: VP14.

Railway investments have stood at approximately 0.35 per cent of GDP in Sweden since the first half of the 2000s, while they were at 0.20 per cent of GDP in Finland, Norway and Germany.

Figure 6.6 shows the development of investments in roads. In Sweden, road investments have remained at an average level in relation to other countries shown in the figure.

Figure 6.6 Infrastructure investments in roads, 1995–2011



Note: There is no data for Denmark for 2011.
Source: VP14.

Road investments in Sweden as percentage of GDP were lower in Sweden than in Norway in 2011, but they stood at approximately the same level as in Germany and Finland.

From a European perspective, there is nothing in the statistics to indicate that Swedish investments in transport infrastructure are too low.

6.2 Socio-economic profitability and infrastructure decisions[8]

A general target for infrastructure policy is to ensure socio-economically efficient transport provision throughout the country.[9] This target has provided a benchmark for a very long time and has not changed with the changes in the political composition of the Government. However, a number of studies have found that cost effectiveness is of little or no significance as regards which investments are made.[10] The Council finds it remarkable that it has

[8] Section 6.2 is based on Börjesson et al. (2014b) and Börjesson et al. (2015).
[9] See, for example, VP15, p. 48. A good discussion on socio-economic benefit and investments in transport infrastructure can be found in VP14, appendix 3, p. 22.
[10] The Lindbeck Commission (SOU 1993:16) highlighted this problem some time ago. See also Börjesson et al. (2015) and the references in this article.

proven so difficult to find any link between the socio-economic benefit per krona invested and the likelihood of an investment being made.

When working on action planning for the period 2010–2021, the Swedish Transport Administration compiled a list of candidates with potential infrastructure projects. The Swedish Transport Administration and the Government then chose which investment objects were to be implemented from this list. The very valuable aspect of this way of working was that it made it possible to evaluate how project selection took place. A recently completed study of action planning is summarised in Table 6.1.[11]

Table 6.1 shows the extent of the investments within each profitability class which were selected by the Government and the Swedish Transport Administration respectively. If socio-economic profitability influences the choice of investments, the units in the upper rows ought to be higher than in the lower rows.[12]

The projects ought to be taken in order in the form of profitability in order to maximise the socio-economic benefit. This would then lead to projects with lower profitability (further down in the table) not being implemented as long as more profitable projects (higher up in the table) remain unimplemented. As can be seen from the table, the Government in particular deviates from such prioritisation.

[11] This study is limited to road investments.

[12] If socio-economic profitability alone determines the choice, all objects must be selected from the highest classes (for as long as they suffice).

Table 6.1 Proportion of road investments in each group selected for the national plan

Investments grouped according to profitability		Government	Swedish Transport Administration
Very profitable	(NPVR > 1)	23%	63%
Profitable	(0.5 < NPVR ≤ 1)	17%	57%
Slightly profitable	(0 < NPVR ≤ 0.5)	16%	41%
Unprofitable	(-0.5 < NPVR ≤ 0)	16%	41%
Very unprofitable	(NPVR ≤ - 0.5)	9%	19%

Note: NPVR refers to what is known as the net present value ratio. The net present value ratio is calculated from the present value of benefits minus the present value of costs for operation, maintenance and investments divided by the investment cost. The estimated social benefit given a certain investment budget is maximised by selecting the proposed investments with the highest NPVR until the given budget is met.
Source: Börjesson et al. (2014b).

The authors of the report found clear patterns when carrying out a statistical analysis of the information, which examined not only socio-economic profitability but also other factors which could affect the choice of project.

The net present value ratio (NPVR), i.e. the present value of benefits minus the present value of costs for operation, maintenance and investments divided by the investment cost, affects the Swedish Transport Administration's choice of investments. The choice is affected by both the absolute magnitude of the NPVR and whether it is greater than zero. Besides what can be explained by the NPVR, investments in metropolitan regions had a greater chance of being selected and investments in sparsely populated areas had less of a chance. This is probably explained by the fact that Swedish Transport Administration has followed the Government's instruction to give priority to specialised labour market regions.

That said, socio-economic profitability played a very small part in the Government's choice of investment objects. The likelihood of the Government selecting an object with a high NPVR increases marginally if implementing the investment does not cost much. That said, the NPVR does not influence the Government's choice of costly investments. These are clearly selected on the basis of other reasons.

The fact that socio-economic profitability has hardly any effect on which objects are selected leads overall to a low benefit per krona invested, particularly as the Government primarily singles out major

investments. In total, the then Government singled out investments worth SEK 70 billion, which generated SEK 77 billion in estimated benefits. If the Government had instead selected the investments which gave the highest estimated benefit per krona invested, it would have been possible to generate SEK 119 billion in benefits for the same budget. In other words, the Government's choices led to a loss of social benefits amounting to SEK 42 billion.

The fact that the Swedish Transport Administration places emphasis on socio-economic benefit from the time it compiles a list of candidates may counteract the problem of the Government attaching so little importance to socio-economic factors. Therefore, we are of the opinion that the Swedish Transport Administration must have a clear instruction to only include socio-economically profitable projects in the list of investments proposed to the Government.

The budget for road investments for the period covered by the study amounted to SEK 95 million. The budget exceeded the total cost for all socio-economically profitable road projects included in the Swedish Transport Administration's list of candidates. Even if the investments had been selected according to a profitability ranking up to this project, the NPVR would have been negative for the least profitable investment. Börjesson et al. (2014b) indicates an NPVR of -0.36 for the last project implemented, i.e. SEK 0.36 was lost for every krona invested. The Council is of the opinion that this is a clear indication that a larger infrastructure budget will not lead to a better socio-economic outcome. The analysis of the Swedish Transport Administration's list of candidates also indicates the importance of ensuring that the Administration is clearly instructed only to include socio-economically profitable projects in its list of candidates.

It has not been possible to carry out a corresponding analysis of infrastructure investments prior to the action plan for 2010 – 2021. However, it is likely that there has been no prioritisation on the basis of socio-economic needs previously, either. We are of the view that inadequate prioritisation has led to socio-economic value failing to increase to the extent that would have been possible.

6.3 Assessments and recommendations

We cannot work on the basis of available statistics to draw the conclusion that investments in roads and railways are neglected in terms of investment volume. From a European perspective, Swedish investments in transport infrastructure are neither high nor low. However, statistics relating to the distribution between investments in roads and railways respectively indicate that a relatively large amount of money has been invested in railways. Railway capital stock per capita has more than doubled over the past two decades.

Maintenance and repair are crucial to ensure the efficient functioning of the road and rail networks. However, it is not possible to state whether resources for the maintenance and repair of roads and railways are sufficient on the basis of statistics and analysis reported by the Government to date. Existing problems may be due to budgets which are too small, but they may also be due to allocated resources being used inefficiently. The level of knowledge in this respect is alarmingly poor. The Government therefore should present a coherent analysis of the maintenance requirement for the Swedish road and rail network in relation to resources allocated. Without an analysis of this kind, there is a major risk that attempts to resolve problems by increasing the maintenance appropriations will lead to a waste of resources, and moreover not result in desirable improvements to the transport infrastructure network.

An analysis of available statistics indicates that Swedish governments in practice attach far too little importance to socio-economic profitability when making decisions on investment plans. An analysis of the roads investment plan decided upon for 2010–2021 indicates that the priorities of the then Government were socio-economically inefficient. Better prioritisations within the plan, comprising SEK 95 billion, could have increased estimated net receipts for society from SEK 7 billion to SEK 42 billion. This is a major waste of resources and probably explains why infrastructure is perceived as insufficient despite a reasonable investment budget. A larger budget is not a solution to the problems.

The socio-economic significance of infrastructure and the obvious shortcomings in the system for prioritising various projects justifies the introduction of a framework for infrastructure decisions. The objective of this should be to clarify the socio-economic

deliberations but not, consequently, to restrict the political power of decision. A framework should include requirements for all decisions on infrastructure investments to be preceded by a socio-economic estimate. A follow-up estimate must be carried out following decisions and implementation. Regulations should be compiled which describe how both decision data and the follow-up are to be formulated. These rules should take into account both the type and the size of projects.

Socio-economic profitability for individual projects is dependent on factors which are not undisputed. Discount rates, the value of fewer injuries and climate effects are examples of such factors. That said, studies show that the ranking between the socio-economic profitability of various projects in practice is very robust as regards variations in such factors.[13] This observation should provide guidance for the structuring of the framework. Therefore, a list ranking the socio-economic profitability of a sufficiently large number of projects should provide a starting point for decisions on infrastructure investments.

Socio-economic estimates do not take into account all aspects, including aspects relating to distribution policy. Therefore, it is not reasonable to prioritise infrastructure investments mechanically on the basis of a ranking based on calculated socio-economic profitability. However, it is crucial to make it clear to politicians and voters what socio-economic costs may be involved in deviating from such a ranking.

Until a framework for infrastructure investments has been put in place, the Government should task the Swedish Transport Administration with publicly ranking proposed projects on the basis of their socio-economic profitability. The cost of any deviations from the list should also be specified. As regards the Administration's own decisions, deviations from any ranking on the basis of socio-economic profitability must always be justified and costed.

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[13] Börjesson et al. (2014a).

7 Fiscal policy and income distribution

In chapter 7, we discuss the role played by fiscal policy in the development of income distribution. In section 7.1, we analyse two standpoints in the current debate on income distribution. In section 7.2, we analyse how transfers and direct taxes have alter the distribution of disposable incomes. Section 7.3 summarises the Council's assessments and recommendations.

7.1 Income distribution and the Swedish debate

An increase in income dispersion is a trend seen throughout the OECD which began in Sweden in around 1980.[1] The current Swedish debate did not relate to this long-term change in the first instance, but focused on development in the years after 2006. In the debate, it is possible to identify two clear, apparently incompatible views of development after 2006. Advocates of the first view, which we can refer to as the "alarmist" view, claim that income distribution has increased dramatically since 2006. Their opponents, on the other hand, claim that income distribution has increased only marginally since 2006. Instead, they cite growing disposable incomes and an effectively functioning social safety network as the most distinctive features of the period after 2006. We refer to this as the "unconcerned" view.

Below are examples of quotations from debate articles which represent the two different views. The articles from which the quotations are taken were written shortly after the election in the autumn of 2014.

[1] OECD (2014e) and Björklund and Jäntti (2011).

The alarmist view

Part of the inheritance (from Reinfeldt and Borg) involves increasing poverty and growing inequality at a level that we would not have believed was possible for a welfare society. According to Statistics Sweden, poverty in Sweden increased by 50 per cent up to 2012. Among workers in the LO collective, the percentage of working
poor has almost doubled. In certain groups, such as the unemployed and the sick, no fewer than 30 per cent of people are now defined as being in poverty. Inequality has increased sharply. From having been at the top of the equality charts, we have now fallen behind all the Nordic countries, but also a number of other countries in Europe. Sweden is one of the countries which has seen the fastest increase in inequality.

Stefan Carlén, Arbetet, 19 September 2014

The unconcerned view

Swedish incomes have increased by 18 per cent between 2006 and 2014. This increase is one of the greatest in the modern age. True, income inequality has increased slightly. But the greatest increase in this came about in the mid-1990s, when you were in office. Since the Alliance took over, income distribution has been "astonishingly constant", and the Gini coefficient, which measures inequality "has "been largely constant", according to the Fiscal Policy Council. Sweden is now the most socially fair country in the EU, according to a major study carried out by the Bertelsmann Foundation. The proportion of people with a very low material standard of living has declined, according to Eurostat, from 2.3 to 1.3 per cent since 2006. The EU average stands at 10 per cent.

Jasenko Selimovic, Expressen, 3 October 2014

Note: The Council wrote that it "(may) possibly appear surprising that the Gini coefficient is so stable between 2006 and 2011" (Fiscal Policy Council 2013, p. 138), and that the spread in disposable income measured using the Gini coefficient "has largely remained constant since 2006" (Fiscal Policy Council 2014, p. 31).

In the sections below, we will be reviewing these views and attempting to examine how inconsistent they are and, if possible, to determine which of them is more accurate.

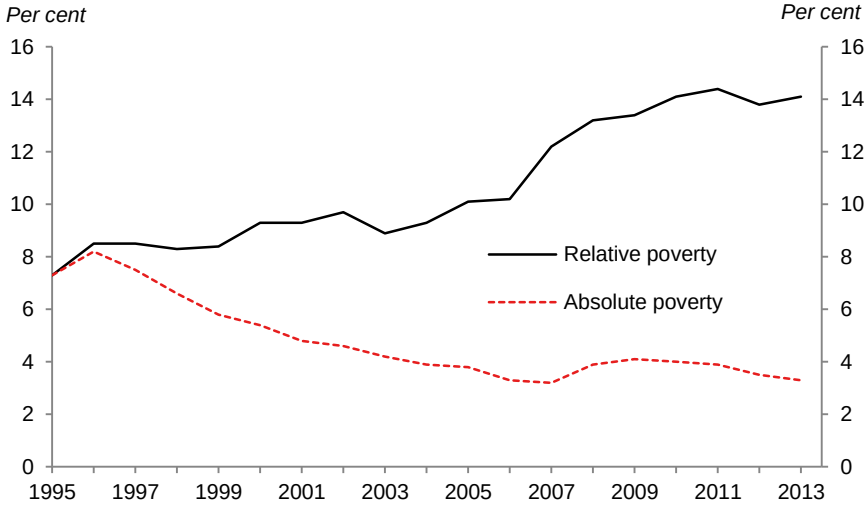
7.1.1 The alarmist view

There is no generally accepted definition of poverty. Researchers use several different measurements depending on what issue they want to examine. Therefore, we will examine how the two most common

measures of poverty, *absolute poverty* and *relative poverty*, have developed between 1995 and 2013.[2]

As a measure of absolute poverty, we will use here the Ministry of Finance's calculations of what it calls the absolute low income threshold, which is defined as 60 per cent of the price-adjusted median income for 1995.[3] When the economy grows, fewer and fewer individuals will fall below this threshold. We can also see from Figure 7.1 that the percentage of people in absolute poverty is on a downward trend between 1995 and 2007. After this, it increases slightly for a couple of years before then falling back towards the 2007 level.

Figure 7.1 Absolute and relative poverty



Note: Relative poverty relates to the percentage of people living in a household with a disposable income per consumption unit of less than 60 per cent of the median value for all individuals in a given year. Absolute poverty relates to the percentage of people living in a household with a disposable income per consumption unit of less than 60 per cent of the median value of the 1995 price-adjusted income.
Sources: Statistics Sweden (2015c) and the Ministry of Finance (2015a).

[2] Other measures of poverty used are the percentage of people receiving welfare benefits (previously referred to as social benefits) and the percentage of people who have no cash margin: see National Board of Health and Welfare (2010).
[3] There are different ways of defining absolute poverty. Certainly, there is a degree of discretion in each choice of poverty threshold. In this case, the threshold amounts to SEK 66,705 per annum in 1995 monetary value.

Relative poverty is often defined as the percentage of the population with less than 60 per cent of the median income in the country.[4] From an international perspective, Sweden has less relative poverty than the average for the OECD countries, but the increase over the past few years has been greater than in most other countries.[5] Relative poverty increased from 7.3 per cent to 14.1 per cent between 1995 and 2013, which is equivalent to an increase of 93 per cent. During the period on which the debate focused, relative poverty increased from 10.2 per cent in 2006 to 14.1 per cent in 2013, which represents a 38 per cent increase.

There are good arguments as to why the development of both absolute and relative poverty must be followed. It is not obvious how to evaluate the development whereby absolute poverty is declining and relative poverty is increasing, as has been the case between 1995 and 2006. That said, it is worrying if both absolute and relative poverty increase, as was the case between 2008 and 2009. The development after 2009 – with unchanged percentages of absolute and relative poverty – is not quite as problematic. However, it does indicate that a trend shift may have taken place in relation to the 1995–2006 period.

Figure 7.2 below shows the development in relative poverty for people in gainful employment and people not in gainful employment. Among people in gainful employment, the proportion of people below the threshold of 60 per cent of the median has remained more or less constant since the mid-1990s. Among people not in gainful employment aged 20 to 64, however, there is an upward trend in relative poverty from the early 2000s, particularly from the middle of the decade. In 2013, approximately 40 per cent of people not in gainful employment were in relative poverty.

The financial crisis and Euro crisis have probably affected development since 2008. Moreover, the reasons for this development are probably related to the falling remuneration rates in social

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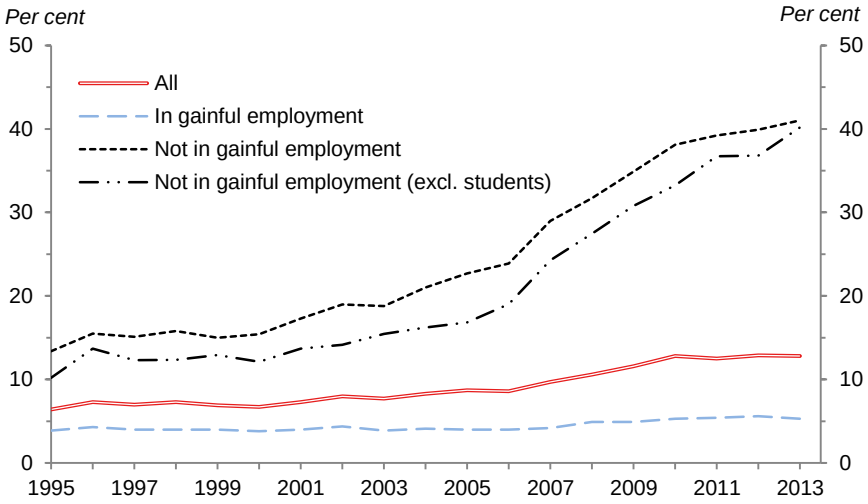
[4] Eurostat defines people in relative poverty as the percentage of the population with less than 60 per cent of the median income; the OECD defines people in relative poverty as the percentage of the population with less than 50 per cent of median income. In 2013, the threshold for relative poverty (according to the Eurostat definition) amounts to a disposable income of SEK 130,320 per annum.

[5] OECD (2008), OECD (2011) and OECD (2013).

insurance since the early 2000s.[6] The policies of the previous Government also contributed to this development. In last year's report, we stated that the earned income tax credit has led to a slight increase in the spread between the lower incomes in the income distribution and the median income.[7]

Figure 7.2 Relative poverty according to employment (20–64 age group)



Note: People not in gainful employment includes the unemployed and the sick (aged 20–64) who have an aggregated income from sickness benefit and labour market support which is greater than half of the combined earned income, plus students and others who do not participate in the labour force. The statistics in the figure are based solely on respondents in HEK. The response frequency in HEK has fallen over time and stood at just over 50 per cent in 2013.
Source: Statistics Sweden (2015c).

In the case of international comparisons, the Gini coefficient for disposable income (excluding realised capital gains) is often used as a general measure of income dispersion. Sweden has had – and continues to have – small income differences compared with most other comparable countries. However, Table 7.1 shows that things have changed slightly since the mid-1990s.[8] Since then, there has

[6] For an analysis of how remuneration levels in social insurance have developed between 1992 and 2012, see Swedish Social Insurance Inspectorate (2014).
[7] See Fiscal Policy Council (2014b), chapter 4.
[8] We are choosing here to use the OECD database, despite the fact that does not include data for certain years. The problems with EU-SILC that we referred to in section 1.4.2 are why we have chosen to use the OECD's data, which was Sweden is based on HEK. Data from EU-SILC also covers a much shorter period than the OECD.

been a certain amount of convergence in income dispersion within the OECD. The dispersion of disposable incomes has declined slightly in countries with the most income dispersion and increased in countries with the least income dispersion. The greatest increases have taken place in Sweden, Denmark and Finland, which despite this are still some of the OECD countries with the most even income distribution. The greatest reductions in income dispersion have taken place in Turkey, Mexico and Chile, countries which nevertheless have the greatest income dispersion within the OECD.[9]

Table 7.1 Gini coefficients in a number of OECD countries

	1995	2005	2011	Change 1995–2011	Change 2005–2011
Netherlands	0.297	0.284	*0.278	*-0.019	*-0.006
Italy	0.327	*0.331	0.321	*-0.006	*-0.010
Hungary	0.294	0.291	*0.290	*-0.004	*-0.001
Czech Republic	*0.257	0.261	0.256	*-0.001	-0.005
Norway	0.243	*0.276	0.250	*0.007	*-0.026
Australia	0.309	*0.315	*0.324	*0.015	*0.010
Luxembourg	*0.259	0.283	0.276	*0.017	-0.007
OECD	**0.300**	**0.320**	**0.320**	**0.020**	**0.000**
Canada	0.289	0.317	0.316	0.027	-0.001
Germany	0.266	0.297	0.293	0.027	-0.004
USA	0.361	0.380	0.389	0.029	0.009
France	*0.277	0.288	0.309	*0.032	0.021
Denmark	0.215	0.232	0.253	0.038	0.021
Israel	0.338	0.378	0.377	0.039	-0.001
Finland	0.222	0.266	0.265	0.043	-0.001
Sweden	**0.211**	***0.234**	**0.273**	***0.062**	***0.039**

Note: * If values are not available for certain years, the values for 1996, 2004 and 2012 respectively are provided instead. For Sweden, for example, the OECD database does not have data for the period 2005–2007.
Source: OECD (2015b).

The Gini coefficient for disposable income in Sweden has increased between 1995 and 2011 by more than six percentage points, or approximately 29 per cent. For the OECD as a whole, the Gini

[9] OECD (2015c).

coefficient has increased by 2 percentage points or approximately 5 per cent throughout this period. In 2011, Sweden had greater income differences than Norway, Finland and Denmark. However, this is the result of a development which began before 2006. In other words, it is not correct to describe this as something which has solely taken place since 2006. It is, on the other hand, correct to say that among the OECD countries the increase in the Gini coefficient is greatest in Sweden, calculated from both 1995 and 2004.

To summarise, we can state the poverty has increased since 2006. On the other hand, it is not clear that this increase is dependent solely on the policy pursued by the previous Government. The financial crisis and Euro crisis have probably contributed to the increase in poverty due to increased unemployment.

7.1.2 The unconcerned view

Advocates of the unconcerned view stress that disposable incomes have increased since 2006. And that is correct. The disposable income total for all individuals, according to HEK, has increased by 21.4 per cent between 2006 and 2013. During the same period, disposable income increased by 16.0 per cent on average if we include realised capital gains, and by 19.6 per cent if we exclude these. Given the fact that the most serious financial crisis since the Second World War occurred during these years, it is slightly surprising that income development has been as good as it has. As we saw in chapter 1, economic policy has contributed to this development.[10] However, this is not a remarkably great increase per se. Between 1998 and 2006, the disposable income total for all households increased by 36 per cent. Disposable income including realised capital gains increased by 35 per cent on average. The increase exclusive of capital gains amounted to 29 per cent.

In chapter 1, we saw that there has been an upward trend in disposable income differences from 1995 to about 2006–2007, from 0.23 to 0.29 up to 2006 if realised capital gains are included, and from 0.21 to 0.25 if these gains are excluded. We also noted that the Gini coefficient for the disposable incomes has not changed at the same

[10] Chapter 1, section 1.4.

pace as previously between 2006 and 2013. The Gini coefficient has remained more or less unchanged if capital gains are included, and has increased from 0.25 to 0.28 if these are excluded. These measures provide no indication that any significant changes to income dispersion have taken place on a general level since 2006. At the same time, we stated that the percentage of people in relative poverty has increased substantially since 2006, and that we have seen a slight increase in the percentage of people in absolute poverty in certain years since 2006.

It may be difficult – using the statistics based on the income concept used by HEK, for example – to gain an accurate view of the situation for individuals with very low registered incomes. One problem with HEK data is that the annual income reported for individuals with very low incomes does not fully reflect the economic standard with which they actually live. In order to illustrate the life situation for these individuals, a measure has been devised within the scope of EU-SILC which aims to measure the absence of goods and services and the inability to participate in everyday activities which may be regarded as socially necessary. This measure is referred to as serious material poverty and is defined as meaning that the individual cannot afford four of the following nine items: an ability to pay unforeseen charges; to take a one-week holiday per year; to eat a meal which includes meat, chicken or fish (or a corresponding vegetarian alternative) every other day; to keep the home sufficiently warm; to have capital goods such as a washing machine, colour TV, telephone or car; or to pay debts (e.g. a mortgage or rent).

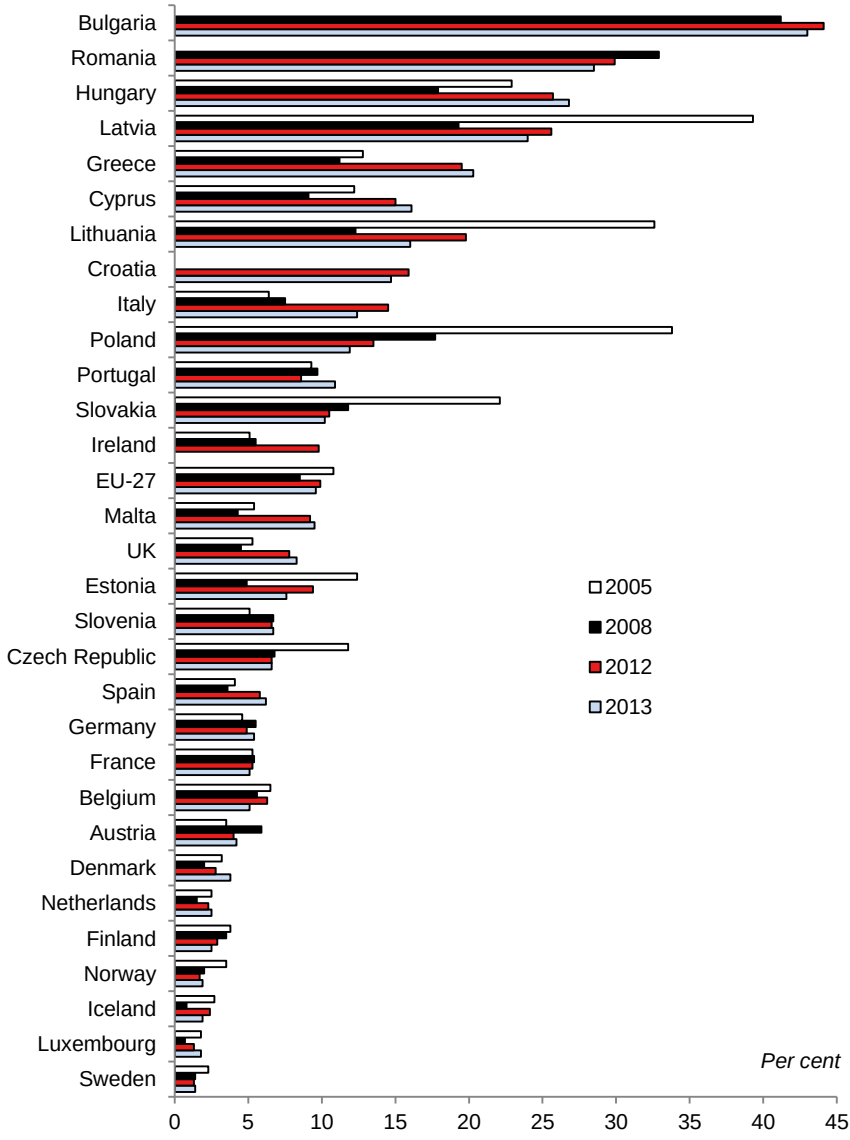
Figure 7.3 indicates that the EU average for the percentage of individuals living in serious material poverty in 2013 stood at 9.6 per cent. The percentage of individuals in this vulnerable situation varies enormously between different EU countries, from approximately 1 per cent to approximately 45 per cent. The lowest percentage can be found in Sweden. The highest percentages can be found in new member states in Eastern Europe. The percentage of individuals in serious material poverty fell in half of the member states between 2005 and 2013. This decline mainly took place between 2005 and 2008. However, there has been an increase in a number of EU countries since 2008. The percentage fell in Sweden between 2005 and 2012: from 2.3 per cent in 2005 to 1.4 per cent in 2008, and to 1.3 per cent in 2012. In 2013, this figure stood at 1.4 per cent, which

is equivalent to approximately 138,000 individuals (approximately 65,500 men and approximately 72,500 women).

There are also broader measures of welfare and the distribution of the same, such as the index designed by the Bertelsmann Foundation (Box 7.1). In its latest report, the Foundation cites Sweden as a top nation in respect of the distribution of welfare in a broad sense.

To summarise, we can state that disposable incomes on average have grown for all income groups since 2006. This is slightly surprising, given the fact that we have undergone a serious international economic crisis during the period. Economic policy has been a contributory factor in this development. At the same time, relative poverty has increased significantly since 2006. Economic policy has contributed to development in this respect as well.

Figure 7.3 Percentage of people with a very low material standard in EU countries in 2005, 2008, 2012 and 2013



Source: Eurostat/EU-SILC (2015).

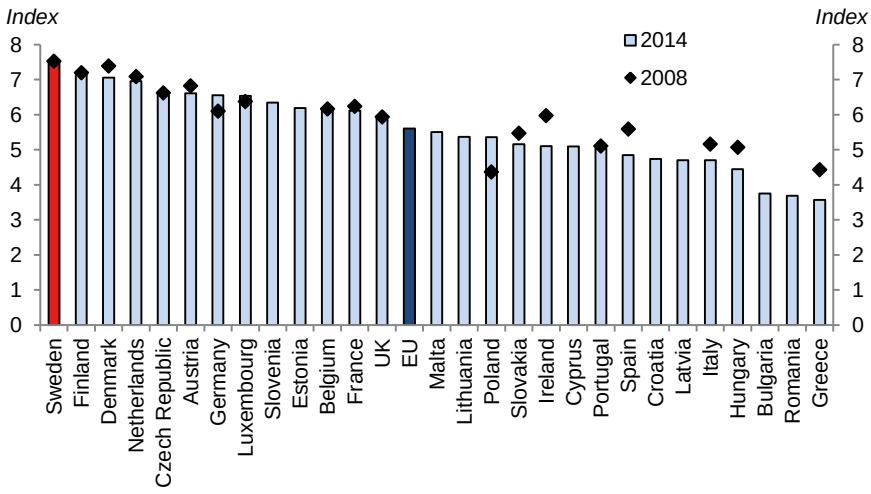
Box 7.1 Report by the Bertelsmann Foundation, 2014

The report "Social justice in the EU – A cross-national comparison" designs an index for the EU countries with a view to measuring different aspects of social justice in society.[11] The higher the index value allocated to a country, the greater social justice is deemed to be in that country.

Sweden and the Nordic countries are ranked top overall, followed by the Netherlands, the Czech Republic, Austria and Germany (Figure 7.4). Countries from southern and south-eastern Europe primarily appear at the bottom of the list.

In the subcomponents, Sweden is ranked top in respect of equality in the education system; social cohesion and non-discrimination; and health and fairness between generations. Sweden is ranked third in respect of poverty eradication, and fifth in respect of access to the labour market. Areas in which development in Sweden has been less good are also indicate: increasing relative poverty, low PISA results, incomplete integration of foreign-born people, high youth unemployment and long queues for healthcare.

Figure 7.4 EU Social Justice Index, 2008 and 2014



Source: Schraad-Tischler and Kroll (2014).

[11] Social Justice Index (SJI), see Schraad-Tischler and Kroll (2014).

7.1.3 Summary assessment

In chapter 1, we stated that there has been an upward trend in disposable income differences from 1995 up to about 2007. Development since then is less clear. As measured with the Gini coefficient, the income distribution has remained largely unchanged since 2007. However, relative poverty rose sharply after 2006, levelling out about 2011–2012. Our description goes a long way towards covering the two views of development over the past few years which we have analysed in this section.

In the alarmist view, development involving increasing inequality is emphasised. However, this is a development which has been ongoing for a number of decades and not something which came into being after 2006. The alarmist description of the development disregards the fact that average disposable incomes have increased for all groups even after 2006, despite the fact that the world has undergone one of the most serious economic crises since the Second World War. It also ignores the fact that the percentage of people in extreme poverty, both in comparison with other countries and in absolute figures, is low in Sweden.

Advocates of the unconcerned view emphasise the growing disposable incomes, the small variations in the Gini coefficient since 2006, an effective social safety network from an international perspective, and the low percentage of very poor people in Sweden viewed from an international standpoint. That said, their description of reality disregards the fact that relative poverty increases significantly after 2006.

The Council finds that the development of income distribution after 2006 is not so clear cut that it can only be described in one way. Different views of the development emerge depending on which segment of income distribution and which development tendencies one chooses to emphasise.

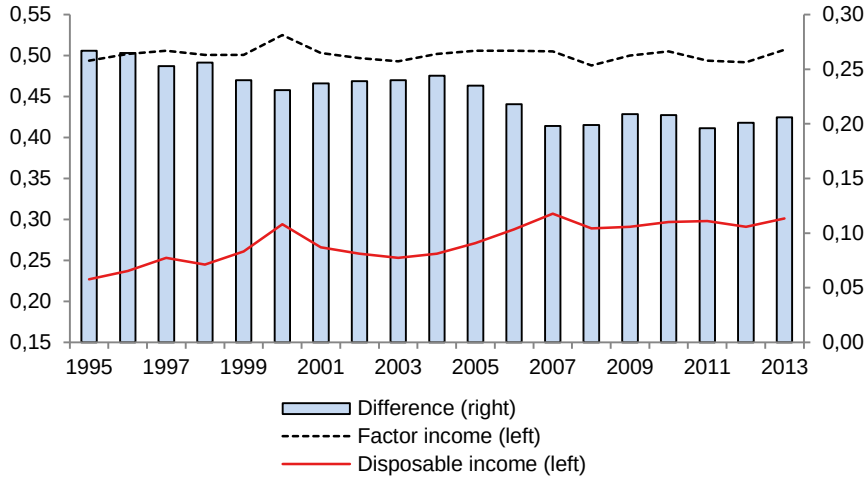
7.2 Taxes, transfers and redistribution

A number of changes have been made to both social insurance schemes and taxes since 1995. This may have been of significance with regard to how income distribution has developed. In Figure 7.5 we show the development of the distribution of factor incomes and the distribution of disposable income, both measured using the Gini coefficient.[12] The difference between factor income and disposable income is direct taxes[13] and contributions deducted or added when making the step from factor income to disposable income. The difference between the Gini coefficient for factor incomes and disposable incomes provides an indication of how redistributive the tax and transfer system is. Major differences indicate stronger redistributive effects, while smaller differences mean weaker redistributive effects.

The distribution of factor incomes, measured using the Gini coefficient, have largely remained stable between 1995 and 2013. The year 2000, in which income dispersion was greater on account of realised capital gains, is an exception. The implication of this is that the increased dispersion in disposable income until 2007 cannot be explained by increased differences in factor incomes. Instead, Figure 7.5 indicates that the overall equalisation effect of taxes and contributions has weakened during this period. Both curves are essentially stable for the 2007 to 2013 period, which indicates that the overall equalisation effect of direct taxes and transfers has remained constant.

[12] Factor incomes are made up of earned incomes, incomes from business and incomes from capital.
[13] Direct taxes here refer to: income tax, general pension contributions, individual contributions for traders, funeral charges, tax on wealth and property tax/property charges.

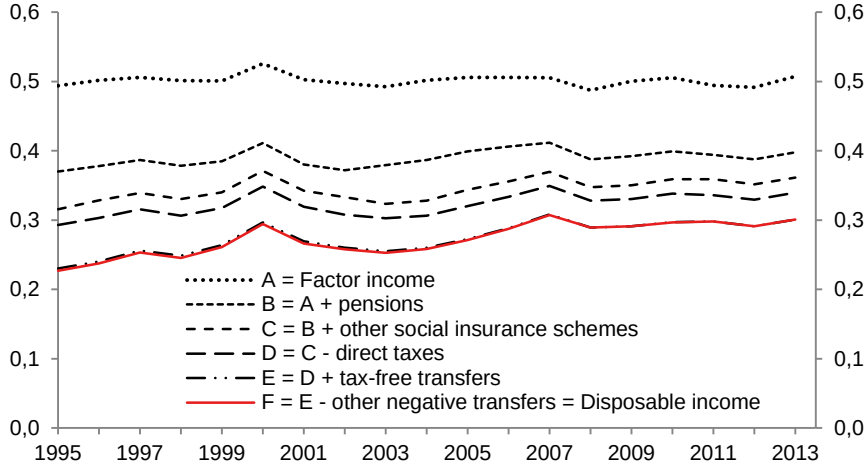
Figure 7.5 Gini coefficient for factor income and disposable income



Source: Statistics Sweden (2015c).

Figure 7.6 below shows how the Gini coefficient changes when we gradually move from the Gini index for factor incomes to the measure for disposable income. Downward movements in the figure indicate equalisation of incomes.

Figure 7.6 The Gini coefficient for factor incomes, and after taxes and transfers



Note: Income per consumption unit.
Source: Statistics Sweden (2015c).

Pensions and social insurance schemes gross before tax have the greatest equalising effect. Direct tax also has an equalising effect, as do tax-free transfers. However, the negative transfers marginally affect the general income distribution.[14]

We are now gradually examining the redistributive effects of various types of transfer. There is no unique method with which to analyse the Gini index.[15] This has led to the occasional flaring of discussions in the literature on which method is best to use in various contexts.[16] The method we use here to decompose the Gini index is mechanical.[17] One problem with our method is the fact that the conclusions may be affected by the order in which we add transfers and deduct direct taxes.[18] However, we are not of the opinion that this is a serious problem in the analysis we carry out here. Here, we split up the difference between factor incomes and disposable incomes into the various transfers and direct taxes which constitute the difference between the two income concepts. We then examine how direct taxes and transfers have altered the difference between factor incomes and disposable incomes over time. Our procedure is easy to follow and intuitively reasonable.

Table 7.2 below analyses the years 1995 and 2013. Row one in the table shows the effect of moving from pure wage and capital incomes (known as factor incomes) to earned and capital incomes, which also include taxable transfers (pensions, unemployment benefits, sickness benefits). The Gini coefficient for 1995 then falls by 17.8 percentage points, from 0.494 to 0.316. Row two shows that the redistributive effect of taxes in 1995 reduces the Gini coefficient by a further 2.3 percentage points to 0.293.

Row three shows the redistributive effect of adding tax-free transfers, which in 1995 reduces the Gini coefficient by 6.3 percentage points, from 0.293 to 0.230. And finally, we deduct the

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[14] Repayment of student loans, repayment of maintenance allowance granted, private pension insurance premiums in business and general deductions relating to premiums for pension insurance/retirement savings accounts are negative transfers. Source: Statistics Sweden.

[15] See Shorrocks (1982) for a discussion.

[16] See Lerman and Yitzhaki (1985).

[17] The analysis approach we use is applied in Flood et al. (2013), in which the redistributive effect of general government welfare services is also examined.

[18] Shapley value decomposition – see, for example, Sastre and Trannoy (2002) – is a mathematical method for dealing with this problem, where applicable.

negative transfers and get the disposable income for which the Gini coefficient is 0.227.

The redistributive effect of the taxable and tax-free transfers in 1995 totals 0.241 (= 0.178 + 0.063). Thus income dispersion fell by almost 50 per cent (0.241/0.494 = 0.49) in 1995 as a consequence of targeted transfers to households. The direct taxes reduced income dispersion in 1995 by more than seven per cent (0.023/0.316 = 0.07).

As we saw in Figure 7.5, the overall effect of taxes and transfers has become less redistributive over time. We will now carry out the same calculation of the redistributive effect of taxes and transfers for the 2013 income year.

Table 7.2 The redistributive effect of taxes and transfers for 1995 and 2013

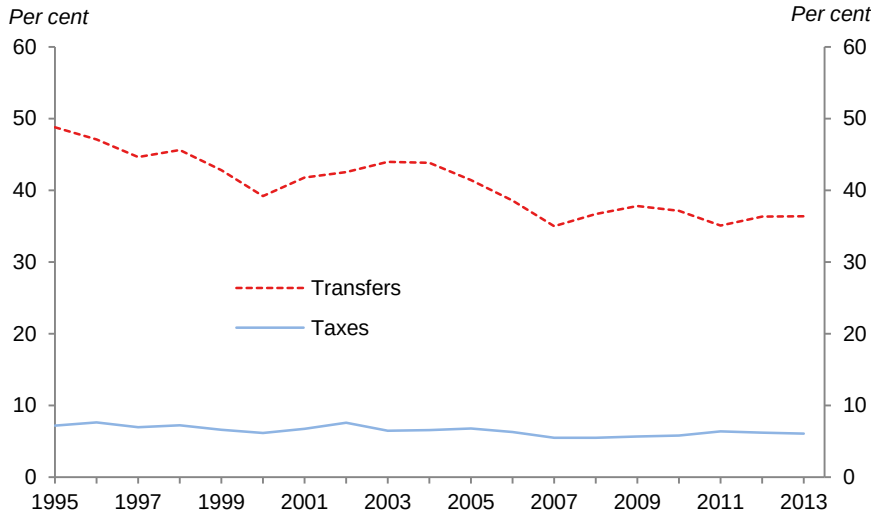
Year	Income prior to redistribution	Redistri-bution	Income after redistri-bution	Redistri-butive effect	Accumu-lated redistri-bution
	1. Factor income	+ taxable transfers	Earned and capital income before tax		
1995	Gini = 0.494		Gini = 0.316	*0.178*	*0.178*
2013	Gini = 0.507		Gini = 0.361	*0.146*	*0.146*
	2. Earned and capital incomes before tax	- taxes	Earned and capital income after tax		
1995	Gini = 0.316		Gini = 0.293	*0.023*	*0.201*
2013	Gini = 0.361		Gini = 0.339	*0.022*	*0.168*
	3. Earned and capital income after tax	+ tax-free transfers	Earned and capital income after tax plus tax-free transfers		
1995	Gini = 0.293		Gini = 0.230	*0.063*	*0.264*
2013	Gini = 0.339		Gini = 0.300	*0.039*	*0.207*
	4. Earned and capital income after tax plus tax-free transfers	- negative transfers	**Disposable income**		
1995	Gini = 0.230		Gini = 0.227	*0.003*	*0.267*
2013	Gini = 0.300		Gini = 0.300	*0.000*	*0.207*

Source: Statistics Sweden (2015c).

The taxable transfers now have a clearly reduced redistributive effect: the Gini coefficient falls by 14.6 percentage points in 2013, from 0.507 to 0.361. On the other hand, the redistributive effect of the direct taxes is almost the same as in 1995: the Gini coefficient is reduced by a further 2.2 percentage points to 0.339. The tax-free transfers in 2013 only have just over half the income-equalising effect they had in 1995. And the negative transfers are so small that they give no response to the third decimal place, which means that the Gini coefficient for disposable income is hardly affected by them.

The redistributive effect of the taxable and tax-free transfers in 2013 is just 0.185, i.e. it has fallen by 23 per cent since 1995. Income dispersion falls in 2013 by more than 35 per cent (0.185/0.507 = 0.36) as a consequence of the targeted transfers to households, compared with more than 49 per cent in 1995. Taxes, on the other hand, have only a slightly reduced redistributive effect in 2013 compared with 1995; taxes reduce income dispersion in 2013 by more than six per cent (0.022/0.361 = 0.06).

Figure 7.7 The redistributive effect of transfers and direct taxes



Note: The redistributive effect of transfers (taxable and tax-free) refers to the difference between Gini for factor incomes and Gini after transfers, and is specified as a percentage of Gini for factor incomes. The redistributive effect of taxes refers to the difference between Gini for earned and capital incomes before and after tax, and is specified as a percentage of the Gini coefficient for earned and capital incomes before tax.
Sources: Statistics Sweden (2015c) and own calculations.

Figure 7.7 above shows the extent to which direct taxes and transfers have reduced income dispersion each year since 1995. The trend is clear: the transfers have become much less redistributive, while the redistributive effect of direct taxes has not changed. Our results are in line with the findings of other studies of the development of the transfers since the early 1990s. These studies show that social insurance benefits have not followed the price and wage changes

after the economic crisis in the early 1990s, when benefit levels were frozen or reduced.[19]

However, our conclusion does not appear to coincide with the analysis made in SNS (2011) and the distribution policy appendix to VP13. These studies use a different decomposition technique and find that the equalising effect of taxes is what has declined over time. We are unable to draw any safe conclusion from our analysis, therefore, but there is much to indicate that the transfers at present are less redistributive than in the mid-1990s.

7.3 Assessments and recommendations

The current Swedish debate into the development of income distribution focuses on the years after 2006. In the debate, it is possible to identify two clear, apparently incompatible views of development. Advocates of the first view, which have referred to as the "alarmist" view, claim that income distribution has increased dramatically since 2006. Their opponents, on the other hand, claim that income distribution has increased only marginally since 2006. Instead, they cite growing disposable incomes and an effectively functioning social safety network as the most distinctive features of the period after 2006. We refer to the latter as the "unconcerned" view.

We find in an analysis that the development of income distribution after 2006 is not so clear cut that it can only be described in one way. Different views emerge depending on which segment of income distribution and which development tendencies one chooses to emphasise. In chapter 1, we stated that there has been an upward trend in disposable income differences from 1995 up to about 2007. Development since then is less clear. As measured with the Gini coefficient, the income dispersion has remained largely unchanged since 2007. The percentage of people in absolute poverty has remained approximately constant, while the percentage of people in relative poverty has increased substantially during the same period.

[19] See, for example, Swedish Social Insurance Inspectorate (2014), which shows that a household with two people in full-time work with low wages since the early 1990s have received an increase in real income of approximately 50 per cent, while the households which are dependent on financial support throughout the same period have seen their income more or less unchanged in real terms.

Our description goes a long way towards covering the two views of development over the past few years which we have analysed in this chapter.

Our analysis of fiscal policy indicates that the transfers have become much less redistributive over time, while the redistributive effect of direct taxes does not appear to have changed. Other studies of the development of social insurance schemes over time point in the same direction. Overall, this indicates that the fiscal policy today is less redistributive than in the mid-1990s.

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