Summary

The coronavirus pandemic is in many respects a unique event, with serious repercussions throughout the world. Drastic measures to stop the spread of the virus and prevent an economic collapse have been rapidly devised. Despite this, the spread of infection has continued, production has fallen, unemployment has risen and incomes have declined for many people and businesses. Nevertheless, the overall economic development has turned out significantly better than there was reason to fear in the spring of 2020, and much better than it would have been without the fiscal measures.

It is against this background that the Fiscal Policy Council's annual report analyses the economic policy issues raised by the pandemic. The Council assesses whether the fiscal measures have had the desired effect and how the economic policy overall relates to the fiscal framework. In addition, the Council considers the role of fiscal policy over the next decade and the lessons to be learned for the future.

This year's report is divided into four chapters. Below follows a summary along with the Council's conclusions.

Chapter 1: The coronavirus pandemic and the development of the economy

Like much of the world economy, the Swedish economy was suddenly and dramatically affected by the outbreak of the pandemic in the spring of 2020. GDP in Sweden fell by 7.6 percent in the second quarter, which is the largest quarterly fall ever recorded. However, most industries recovered later in the year and on an annual basis, GDP decreased by 2.8 percent. Compared to the Euro area, where GDP fell by 6.8 percent in 2020, the Swedish economy has fared relatively well.

In Sweden, as in many other countries, demand in contact-intensive industries has remained low since the outbreak of the pandemic. Mainly workers with fixed-term contracts – especially the young, low-skilled and foreign-born – have lost their jobs. This has exacerbated problems which pervaded the Swedish labour market already before the pandemic. At the same time, stock and housing prices have continued to rise rapidly which, together with the increase in unemployment, has led to a more uneven distribution of income and wealth.

The crisis has presented major challenges for fiscal policy due to uncertainty about the development of the pandemic, the impact of the crisis on the economy and the appropriate scope and focus of support measures. The support measures for 2020 were estimated in April 2021 at approximately SEK 160 billion, and the fiscal balance fell to -3.1 percent of GDP. The government projects that continued and extended measures for 2021 will weaken the balance further, to -4.5 percent of GDP, which is the lowest figure since the crisis of the 1990s. The Maastricht debt rose to about 40 percent of GDP in 2020 and is expected to remain unchanged in 2021.

The ongoing vaccination gives cause for some optimism and the government forecasts good growth this year and next. However, this projection is based on the pandemic loosening its grip later in 2021. The Council's assessments are also based on this premise. Manufacturing has recovered and contact-intensive industries are expected to experience a boost when the restrictions are lifted. Jobs can then be expected to return in the most affected sectors, reducing the risk of the crisis having major and long-lasting negative impacts on the labour market. However, should the pandemic become significantly more protracted than what now seems to be the case, both the scope and direction of the measures may need to be reassessed.

Chapter 2: Fiscal measures during the coronavirus crisis

In order to assess the measures taken, a clear picture of their different objectives is needed. Naturally, an overarching aim of many measures has been to protect life and health. However, assessing the effects of infection-control measures falls outside the scope of the Council's work. The economic objectives of the measures can be summarised in three categories: enabling the economy to “hibernate”, mitigating the decline in demand and protecting economically affected groups.

In a crisis situation such as the current pandemic, there are strong reasons for the state to act as an insurer and to provide direct support to companies, individuals, municipalities and regions. State aid should be designed to achieve the greatest possible impact at the lowest cost. This is achieved if the aid is timely, targeted, temporary and transparent. The aid should also be linked to deductibles in order to increase accuracy and reduce the risk of exploitation or cheating.

The long-term impact of aid on the economy is another issue. It is currently reasonable to assume that, after the crisis, the economy will essentially return to the same structure as before, which suggests that aid should remain in place as long as the pandemic limits demand. Companies' need of aid is unlikely to diminish as the pandemic continues. By linking pay-outs to deductibles, the use of aid will decrease automatically when demand in the economy returns. At the same time, it is important that aid does not remain in place longer than necessary so as not to hinder desirable structural change.

Regarding the overall direction and size of economic policy measures, the Council finds that the government and Riksdag have in general acted quickly and forcefully given the challenges facing the Swedish economy. The measures taken have undoubtedly helped to limit the economic damage of the pandemic and most of the measures have been designed to reach the objectives in a relatively effective way. Short-term work, aid supporting firms' fixed costs, support for loss of income for self-employed and deferral of tax payments are overall accurate measures, partly because they are linked to deductibles. They have contributed significantly to companies' ability to "hibernate" through the crisis. On the other hand, general payroll tax reductions have poor accuracy as they benefit all employers, regardless of whether they are affected or not. This type of measure should therefore be avoided in the future and replaced with more accurate forms of aid.

The temporary increase in unemployment benefits and the temporary reduction of requirements for claiming compensation were appropriate measures from a stabilisation policy perspective, and alleviated the need for other financial support. Increased funding to the municipal sector has allowed the healthcare sector to respond to the pandemic without being restricted by financial limitations. It has also supported employment and demand.

Several of the aid measures were introduced relatively quickly. This was particularly important for businesses as the economy, at the beginning of the crisis, was in almost freefall and could have suffered many more redundancies and bankruptcies than it eventually did. The support measures are in general temporary by design, which facilitates a rapid improvement in public finances after the crisis. However, the Council's view is that the government should have given earlier notice of the extension of the support for firms' fixed costs in 2020 and that the aid to self-employed came very late. We are also critical of the fact that compensation levels and deductibles have changed repeatedly.

The changes have created needless uncertainty and made it difficult for companies and individuals to make informed decisions.

An important component of monitoring and evaluating support measures aimed at businesses is access to relevant statistics. Information on which companies receive aid should also, to the highest extent possible, be publicly available to facilitate external review and evaluation. Access to data improved gradually, but the Council considers it important to identify, at the stage when the aid is designed, the type of statistics to be collected and to ensure that this is part of the aid design and management. The application procedure for various types of aid should also be coordinated in a common portal. This would make the support measures easier for companies to navigate and, at the same time, reduce the risk of incorrect pay-outs. All in all, it would create better conditions for designing efficient aid in the future.

Chapter 3: Fiscal policy and the fiscal framework

There is a deviation from the surplus target in both 2020 and 2021. In light of the coronavirus crisis, the deviations are reasonable. Comprehensive measures have been needed to support the economy through the crisis and the Council sees no clear argument why the size of the overall measures should have been significantly different. The deviations do not violate the fiscal framework – it allows the fiscal balance to vary with the economic cycle.

If there is a deviation from the surplus target, the government is obliged to present a plan on how the balance will return to target. However, the government has not presented a clear plan either in the Budget Bill for 2021 or in the 2021 Economic Spring Bill, even though uncertainty ought to have diminished significantly since last spring. The Council believes that the government should have set out a clear plan for a return to the surplus target. The requirement for the government to report on how to return to the surplus target exists for a reason; to force a political process and clarify commitments which lead the surplus target to be met in the future. Otherwise, confidence in the fiscal framework may be damaged and evaluation and accountability prevented. Obviously, a plan may need to be revised in the face of changing circumstances.

In a committee initiative, the Riksdag decided to inject approximately SEK 4 billion in increased expenditure in 2021, which was a departure from the principle of unitary budget decisions. Similar departures happened in 2013 and 2020, and the Council was critical on both occasions. Moreover, the 2021 initiative resulted in an unfunded increase in expenditure, which further weakens the Riksdag's budget process. The Council is increasingly concerned about this development. The Riksdag's budget process is a crucial part of the fiscal framework that has served Sweden well in recent decades and it is very important that the principle of unitary budget decisions is maintained. The recurring committee initiatives, and the lack of a clear plan for a return to the surplus target, are ominous signs that the fiscal framework is in danger of being eroded.

The expenditure ceiling is a key budgetary policy commitment that contributes to budgetary discipline and credibility of public finances. After the outbreak of the pandemic, the government significantly raised the expenditure ceiling for 2020. During the autumn, the ceilings for 2021 and 2022 were also raised substantially. The expenditure ceiling for 2023 is however expected to return to the same share of GDP as before the pandemic. These increases risk weakening the disciplining function of the expenditure ceilings. An alternative to the large increases would have been to make minor revisions to the expenditure ceilings on a regular basis, but this would also have risked damaging the credibility of the expenditure ceiling. The Council deems the increases in the ceilings for 2020–2022 to be acceptable, but stresses the importance of returning the ceiling to pre-pandemic levels so that the function of the ceiling is restored.

Like the National Institute of Economic Research, the government believes that the economy will reach potential in 2023, by which time the fiscal balance will be in line with the surplus target. The Council finds that such a development is reasonable and in line with the fiscal framework. If the recovery is stronger and the economy enters a boom, fiscal policy should be tightened in line with the framework so that the structural balance exceeds the level of the surplus target. If, instead, the economic situation deteriorates, there is scope for fiscal policy to continue to support the economy. In such a scenario, the debt ratio would temporarily be slightly higher than in the government's forecast. However, the Council's view is that such a development would not be problematic.

Chapter 4: Fiscal policy in a world of low interest rates

The past year has affected the conditions for both fiscal and monetary policy. The economic crisis has increased knowledge and given new experiences on fiscal measures and the possibility of making urgent decisions. The crisis has also meant that the interest rate has been lower than it would otherwise have been, which limits the scope for monetary policy measures in the coming years. At the same time, continued low interest rates imply that the cost of government debt is low, although interest rates are expected to rise slightly in the future. Overall, this development raises several questions.

A first question concerns the role of fiscal policy over the economic cycle. As long as monetary policy space is limited, fiscal policy may need to be used more often to counter recessions than we have been used to. There are also risks associated with various monetary policy measures. Both a low interest rate environment and central bank support purchases affect financial markets; the longer it continues, the greater the risks of serious financial imbalances.

The notion that fiscal policy may need to be used more does not mean that the stabilisation policy approach should be completely reassessed. Monetary policy should continue to have the main stabilisation policy responsibility when the interest rate situation so permits. It is important to take seriously the limitations and risks of fiscal policy. Against this background, the Council suggests that the government should set up an inquiry to prepare appropriate fiscal stabilisation policy measures.

An increased stabilisation role for fiscal policy means a greater need for interaction with monetary policy. It is important, then, that the various actors have a realistic picture of the other's ambitions and their possible reactions to changes in the economic situation. This presupposes both well-developed public communication and an ongoing dialogue between the government and the Riksbank. The fact that the credibility of both fiscal and monetary policy is high, combined with the Riksbank having a high degree of independence, implies that conditions for good interaction are favourable.

A more active fiscal policy also means that both public savings and indebtedness will vary more over the business cycle. However, the Council finds that the associated risks are limited as long as deficits in a recession are followed by surpluses in a boom and the fiscal framework is followed. Risks are also limited by low interest rates keeping borrowing costs down and by maintaining government debt at a relatively low level. In addition, the fact that nominal GDP growth is expected to continue to exceed the government bond yield induces the debt ratio to decrease over time.

A second question discussed both in Sweden and internationally is whether low interest rates make higher public debt less problematic. However, there are strong arguments in favour of low public debt despite low interest rates. For private operators, it may be rational to increase debt in a low interest rate climate, but this is not necessarily the case for the state. The coronavirus pandemic is a good example of the state's broader role as an insurance provider to the economy; extensive resources may be required to support households and businesses in times of crisis. Extensive private debt build-up in Sweden and high public debt globally have reduced the resilience of the economy, which means an increased need for a strong fiscal position. Trade conflicts and geopolitical instability also contribute to high uncertainty. Overall, these circumstances suggest that the fiscal position should not be weakened. Moreover, climate change has a bearing on the issue of appropriate public debt. The Council intends to return to the issue of climate change and public finances in future reports.