Summary

The political and economic situation has changed rapidly and dramatically several times in recent years. The global pandemic was followed by a strong recovery driven by expansionary policy and pent-up consumption. High demand, in combination with bottlenecks in production and transport, led to rapidly rising inflation. Russia's war of aggression on Ukraine brought further dramatic price increases, especially for energy, and induced great general uncertainty about global developments. As a result, monetary policy was realigned rapidly, leading to large interest rate increases for households and businesses.

The combination of high inflation and falling demand is challenging for fiscal policy. Expansionary measures to alleviate the sharp decline in households' purchasing power need to be balanced carefully against the objective of preventing high inflation from taking hold.

This year's report is divided into six chapters, the first four of which deal with economic developments and fiscal policy in the past year. In Chapter 1 we draw a picture of macroeconomic developments internationally and in Sweden. In Chapter 2 we analyse whether fiscal policy is consistent with the fiscal framework and the budgetary targets. In Chapter 3 we extend this analysis and discuss whether fiscal policy, including electricity support, was an appropriate stabilisation policy in light of the prevailing forecasts when the budget was presented in the autumn. In Chapter 4 we describe the development of the electricity market and assess the scale and design of the electricity support schemes. In Chapter 5 we analyse how fiscal policy has been conducted over the business cycle in the past two decades. We conclude with a chapter in which we discuss some issues that are relevant to the future of the fiscal framework, and which ought to be considered in the coming framework review.

Chapter 1 – The state of the macro economy

The Russian invasion of Ukraine in the spring of 2022 meant a dramatic deterioration of the security situation and has led to major economic stresses in the past year. The prices of fuel, agricultural products and certain input goods have risen sharply.

The rapidly rising inflation last year contributed, along with the elevated uncertainty and the rapid interest rate increases by central

banks, to a considerable slowdown in economic growth in the second half of 2022. In 2023 growth is expected to be weak in both the US and Europe. Several factors, such as the security situation in Europe and the risk of an international financial crisis, underscore that the situation could deteriorate further.

In Sweden both the Government and the National Institute of Economic Research (NIER) make the assessment that growth will be negative this year and that the recession will continue next year. Thus far the labour market has withstood the decline in economic activity, but unemployment is expected to increase slightly both this year and the next. In late March the social partners in industry reached a two-year agreement involving wage increases of 4.1 per cent this year and 3.3 per cent next year. Since then several other sectors have reached similar agreements. This upward shift in wage growth, along with for instance electricity support and the price indexation of certain transfer systems and tax scales, mitigates the decline in households' purchasing power. These factors do not, however, fully offset the high inflation; households' real disposable incomes are expected to fall in both 2022 and 2023. The rapid rise in interest rates has also led to price declines for homes and other assets. As such, household finances have worsened due to both lower real incomes and reductions in asset values.

To sum up, the Swedish economy is in an uncertain situation characterised by high inflation and low growth. This poses difficult questions to economic policy. At the same time, some bright spots have been seen in early 2023; inflation is falling abroad and the social partners have reached a two-year agreement that we assess is consistent in the long-term with the inflation target.

Chapter 2 – The fiscal framework

The public finances remain very strong, despite the challenges faced by fiscal policy in recent years. Even if the recession may result in budget deficits both this year and the next, public debt remains low, both from a historical perspective and in relation to most comparable countries.

The Council's assessment is that the fiscal policy in the Budget Bill for 2023 and the Economic Spring Bill of 2023 was in line with the fiscal framework. The recession could, taken alone, justify a more expansionary policy. However, the framework provides scope for

taking account of inflation and monetary policy challenges, as the Government has done. Chapter 3 discusses whether fiscal policy was appropriately designed to handle the present economic situation.

There are several unclarities in the Budget Bill that make it difficult to assess the Government's reasoning. There is no clear explanation of how the Government arrives at its assessment of the fiscal impulse. Furthermore, which is more serious, the Government has changed the method for calculating potential GDP. This change, which has major effects on the structural balance, is made without offering any rationale or discussion of its consequences. Clarity is a cornerstone of the framework, and this lack of transparency surrounding the most central variable for assessing fiscal policy's alignment with the surplus target is remarkable.

The budget process has returned to normal after some turbulent years during the pandemic. Nevertheless, the Council is still concerned about the budget process looking ahead. There was a rapid erosion of established practice during some of the preceding years, and the recent improvement is likely explained by the current parliamentary situation.

When the new Government took office, the expenditure ceilings were raised, which is in line with established practice. The ceilings were also raised at the government transitions in 2006 and 2014. As a share of GDP, the expenditure ceiling is largely unchanged in the coming three years, with a marginal decrease for 2026 being announced in the Economic Spring Bill of 2023. The expenditure ceiling as a share of GDP is an important economic variable. However, the expenditure levels proposed have not been motivated extensively. More attention ought to be given to how the Government views the development of public expenditure in the medium-term.

Chapter 3 – Fiscal policy in times of high inflation and falling demand

The Government was confronted with a complicated stabilisation policy situation in the autumn of 2022; high inflation was expected to coincide with an approaching recession. In such a situation, fiscal policy cannot be decided solely on the basis of its effect on the business cycle. It is essential to also take account of inflation to avoid counteracting monetary policy. In this context, consideration needs to be given to the household sector's high indebtedness, a large portion of which is adjustable-rate loans. This makes the assessment uncertain; monetary policy can quickly have a stronger than desirable effect, with

negative consequences for financial stability. In the autumn the social partners had also recently started negotiations on a new agreement against a backdrop of high inflation and falling purchasing power.

The fiscal policy in the Budget Bill for 2023 must be described as cautious. Absent the high inflation there would have been grounds for a more expansionary policy. The Council considers the scale of fiscal policy – including capacity charges and electricity support – to be reasonable given the risks of persistently higher inflation and a sustained period of high interest rates, with undesirable economic effects via the housing market. The same largely applies to the Economic Spring Bill. However, it would probably have been possible to pursue a slightly more expansionary fiscal policy without it causing any great problems for monetary policy. The relatively tight fiscal policy means that the Government may introduce additional measures in the future if the recession continues and the inflationary pressure moderates.

As regards the content of fiscal policy, there is cause to be more critical. The dramatic deterioration of households' purchasing power justifies that some support was introduced. That it was mainly given in the form of electricity support can in part be explained by the regulations in place. However, support for electricity consumption is difficult to reconcile with the ambition of lowering electricity use when supply is limited and shortages risk occurring.

The Council considers that the electricity support schemes were too extensive. With more limited electricity support, there would have been scope, without creating problems for monetary policy, for more targeted measures to particularly vulnerable households. The Economic Spring Bill's temporary measures targeted at families with children receiving housing allowance and vocational education are examples of such measures. In a situation of high inflationary pressure, there should also be a focus on measures that improve the economy's growth potential. Measures of this kind are largely absent in the 2023 Budget Bill.

Chapter 4 – Electricity support for households and businesses

There are strong reasons to not compensate for price changes in various markets. Price is the mechanism that makes supply and demand meet; if the State provides compensation for increases in the price of electricity, it decreases the incentives for households and

businesses to be economical in their use of electricity and invest in energy-efficiency measures. This means that the risk of price peaks and electricity shortages remains, even in the longer term. State compensation for higher prices on a market may also create a political dynamic involving interventions in more markets where prices rise.

In light of the major price increases on electricity and the uncertainty concerning how high the prices would become in the winter of 2022–23, as well as the EU regime that governs how the capacity charges may be used, it was reasonable to introduce some electricity support. However, the Council's view is that the electricity support schemes became too extensive, that their design was inadequate in certain ways and that repeated support schemes generate incentive problems.

The support schemes for households ought to have been limited by e.g. a consumption-based ceiling above which no support would be given. The Council is particularly critical to the third electricity support scheme announced in January 2023. This support scheme provides compensation for electricity costs in November–December 2022. For households in electricity areas 3 and 4, this period was already covered in the second support scheme, which was announced in August 2022. When the Government presented the third support scheme at the beginning of January, it was also clear that prices in November–December 2022 became lower than feared in the autumn. It is therefore difficult to understand how the need for electricity support can have been deemed higher in January 2023 than when the second electricity support scheme was announced.

The Council is also critical to the announced scale of electricity support to businesses. Businesses have to a large extent been able to pass on their higher electricity costs to consumers, and businesses that consume a lot of electricity tend to have fixed electricity contracts at comparatively low prices. Any support to businesses ought, as far as possible, to be targeted to those that have had higher electricity costs. Above a certain consumption ceiling, it should be required that businesses demonstrate their costs, combined with a maximum amount per business.

Finally, the Council is critical to the handling of the electricity support schemes. Many features of the measures are inherently political. The Government also has greater capacity than agencies to process proposals. The Government ought to have taken on a more

active role to influence the size and design of the support schemes, and ought also to have taken full responsibility for the policy. Moreover, information about the support schemes and their recipients must be available for scrutiny. Policies must be transparent and possible to evaluate, and there has to be accountability.

Chapter 5 – Fiscal policy over the business cycle: 2002–2022

In recent years there has been increasing discussion, both internationally and in Sweden of the role of fiscal policy in macroeconomic stabilisation. In addition to the limitations of monetary policy, experiences from both the pandemic and Russia's invasion of Ukraine have shown that, from time to time, fiscal policy needs to take on an active role. At the same time, the experiences from the 1970s and 1980s are still relevant; several drawbacks of active fiscal policy remain pertinent.

The Council makes an annual evaluation of how fiscal policy corresponds with the business cycle. These evaluations focus on a single year and are normally made in the year after the decisions were taken. These annual evaluations can be supplemented by a systematic analysis on a longer time period. An analysis of this kind is presented in Chapter 5.

Our analysis indicates that, on average, active fiscal policy has been countercyclical 2002–2022. This applies both to the intentions of fiscal policy, as expressed in Budget Bills, and to the fiscal policy outcomes as measured retrospectively. According to our analysis, the number of times when fiscal policy was clearly procyclical are few, as regards both intentions and outcomes.

This result is consistent with the view that the stabilisation policy frameworks, with rules for fiscal policy and an independent central bank, have worked well. The fiscal framework was developed in light of historical problems and prescribes not only that fiscal policy be conducted countercyclically, but also that the scale of policies should be fitted to the magnitude of the fluctuations in the economy. This appears to have worked.

Altogether, the results indicate that fiscal policy's prospects of stabilising the economy are better than their reputation. Whether this continues to apply in the future will depend ultimately on political decisions; but if the main components of the fiscal framework remain in place and are respected, there are grounds for cautious optimism.

Chapter 6 – The frames for fiscal policy

Finally, we analyse some issues of importance for the future fiscal framework. The next review of the framework needs to begin in around a year's time in order to be completed by 2027 when the next framework period begins.

The principle of intergenerational equity – that welfare commitments and tax levels should be equal across generations – suggests that the surplus target and debt anchor may need to vary over time. A demographic hump that means relatively few people of working age may for instance justify a lower surplus target and a higher debt anchor. In contrast, permanently higher ambitions – irrespective of whether they concern elderly care or defence – should be fully funded and do not justify changes in target levels.

In addition to demographic trends, it is important that the next review assesses whether there will be an investment hump during the next framework period. As we pointed out in last year's report, more knowledge is needed on climate investments requiring full or partial public funding. Moreover, Sweden's defence ambitions have increased. We cannot assess the scale of the required defence investments, but any investment humps need to be analysed. In addition, central and local government investment requirements need to be taken into account, including the infrastructure plan to be published in 2026, i.e. the year before the start of the next framework period.

The next review also needs to regard that, as in the decade before the pandemic, advanced economies may be characterised by so called secular stagnation. This is a situation of relatively weak growth and low inflation despite very low interest rates. In such a situation, monetary policy may again resort to extreme measures such as a negative policy rates or extensive asset purchases to maintain full employment and target inflation. A lower surplus target to increase the public sector's contribution to demand – so called functional finance – could be an alternative such monetary policy. Research related to the US economy indicates that functional finance can be effective, but an analysis is still needed of the extent to which these results are applicable to a small, open economy like Sweden. The coming review should investigate whether the Swedish economy risks returning to secular stagnation and whether, if that happens, a lower surplus target is preferable to more extreme monetary policy measures.