THE SWEDISH FISCAL POLICY FRAMEWORK

REGERINGSKANSLIET

Government Offices

Foreword

In the 2010 Spring Fiscal Policy Bill, the Government announced that it would present a code of conduct for fiscal policy. As a result, the Government recently submitted a Government Communication, "Fiscal Policy Framework" (Skr. 2010/11:79), to the Riksdag (the Swedish parliament).

The Communication describes a code of conduct for fiscal policy. The purpose of the Communication is to enhance fiscal policy sustainability and transparency by institutionalising important principles used by the Government. The Communication serves to present and summarise the fiscal policy framework.

In the Communication, the Government clarifies what the fiscal policy framework comprehends and how it is implemented. Besides principles for the central government budget process, budgetary goals and rules, the framework includes central principles for measures of stabilisation policy and for financial market interventions. These principles are founded on the experience gained from the economic crisis in the early 1990s and the recent crisis. Furthermore, the framework includes important principles for openness and clarity in fiscal policy presentation.

The Swedish Government intends the Communication to increase knowledge about and support for the central principles used by the Government, and thereby to contribute to further enhancing the credibility of Sweden's fiscal policy conduct and its long term sustainability.

This offprint presents an English translation of the Government Communication (Skr. 2010/11:79).

Stockholm in March, 2011

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Summary

This document describes and specifies the Swedish fiscal policy framework. It consists of a number of principles the government uses as a steering-oar in its conduct of fiscal policy with the aim to make fiscal policy sustainable in the long run and also transparent. Some elements of the framework are prescribed by law, others stem from the practice developed since the crisis in the government finances in the early 1990s. The central features of the fiscal policy framework can be summed up in the following points:

The fiscal policy framework's role in the political decision-making process

- The overall objective of fiscal policy is to create as much welfare as possible by promoting high and sustainable economic growth and employment (by means of structural policy), welfare that extends to everyone (by means of redistribution policy) and stable resource utilisation (by means of stabilisation policy). Sustainable growth means economic growth that is achieved without unacceptable effects on the environment, the climate or people's health. A fundamental precondition for being able to attain the overall objective of fiscal policy is the long-term sustainability of the public finances.

- Fiscal policy has several different goals and means. The conflicts that arise between goals have to be managed by the electorate's representatives in the Riksdag (the Swedish parliament). The conduct of fiscal policy naturally varies over time, depending on the Riksdag's composition. Consequently, fiscal policy as a whole cannot be mechanical or described in terms of a set of principles. There are, however, a number of fundamental principles that fiscal policy should observe in order to achieve long-term sustainability and transparency. These principles collectively constitute the fiscal policy framework.

The budgetary framework

- A central component of the fiscal policy framework is the budgetary framework, which comprises a surplus target for general government net lending, an expenditure ceiling for central government and the old-age pension system, together with a stringent central government budget process, and a balanced budget requirement for local governments.

- The government has a statutory requirement under the Budget Act (2011:203) to propose a target (the surplus target) for general government net lending. The Riksdag has decided that the surplus target is that net lending shall amount to 1 per cent of GDP on average over a business cycle. The present level of the surplus target shall be maintained during the current term of office and for as long as is necessary for a sustainable long-term development of the public finances.

- Surplus target evaluation is mainly forward-looking to assess a room for reform or a need for consolidation measures. Since the economic situation and the business cycle cannot be measured precisely, the surplus target is monitored with a set of indicators. The uncertainty in the assessment is also taken into account, along with the risk of development deviating from the forecast and the possibility that the business cycle is asymmetric. These factors are used to arrive at an overall assessment of the room for reform or the need for consolidation measures.

- Departures from the surplus target have to be corrected. However, this cannot be done mechanically. An assessment of when and how a deviation is to be corrected has to be based on an overall assessment taking into account stabilisation, redistribution and structural policy objectives.

- The Budget Act requires the Government to propose in the Budget Bill an expenditure ceiling for the third year to come. The Riksdag decides the expenditure ceiling.

- An important function of the expenditure ceiling is to provide conditions for achieving the surplus target. The ceiling's level should also promote a desirable long-term development of central government expenditures. Together with the surplus target, the expenditure ceiling guides the level of the total tax take and helps to prevent a development where the tax take gradually has to be increased as a result of insufficient control of expenditures.

- The expenditure ceiling should not be circumvented by arranging for benefits that normally are financed with appropriations, to be budgeted and booked under revenue headings. Moreover, the primary principle for booking expenditures is that they are assigned to the year for which they are intended. Any departures from these principles have to be motivated.

- The practice is to include a budget margin of a certain size below the expenditure ceiling. The margin is to function in the first place as a buffer if economic developments cause expenditures to differ from the original estimates.

- A well-organized and stringent budget process is a central factor for achieving the budgetary goals. The budget process's overall restriction in terms of total expenditures is the expenditure ceiling. In the budget process different expenditures are weighed against one another and expenditure increases are assessed in relation to a total economic capacity that is pre-determined by the expenditure ceiling and the surplus target. The main principle is that proposed increases in a particular expenditure area should be balanced with proposed reductions in the same area.

- Another matter of central importance is that the central government budget is transparent and comprehensive. The Government's draft budget is to comprise all revenues and expenditures as well as other payments that affect the borrowing requirement (the principle of completeness). Moreover, the main principle for budgeting and booking central government revenues and expenditures is that this be done gross under revenue headings and appropriations (the gross-accounting principle). This means that expenditures are booked on the expenditure side of the budget and revenues on the revenue side.

- The Ministry of Finance has a coordinating role and responsibility for timetables, guidelines for budget work and the processes for budget negotiations. However, every ministry is responsible for the existence of a sufficient foundation for establishing overall priorities between different parts of the public sector and between different expenditure areas in the central government budget, as well as for assessing the public sector commitment.

- To strengthen the budget process at the local level, a balanced budget requirement for local governments has been in force since 2000. The requirement states that, except under special circumstances, every municipality and county council shall budget revenues to exceed budgeted expenditures. Municipalities and county councils shall also practice sound economic management.

Stabilisation policy

- Fiscal policy's main contribution to economic stabilisation lies in maintaining confidence in the long-term sustainability of the public finances. A lack of sustainability makes it more difficult for the Riksbank (Sweden's central bank) to maintain price stability. Experience indicates that periods of high inflation are often preceded by periods of mismanaged public finances. A loss of confidence in the public finances on the part of financial markets, households and firms will also tend to weaken the effect of active fiscal measures on behalf of stabilisation policy.

- In the event of normal demand shocks, monetary policy normally contributes to a stabilisation of inflation as well as demand. There is then no need for any active fiscal measures. When such shocks

occur, fiscal policy contributes to economic stabilisation via the automatic and semiautomatic stabilisers.

- In the event of very large demand or supply shocks, fiscal policy may need to support monetary policy actively. Crisis management experience indicates, however, that a major economic downturn cannot be fully counteracted by discretionary fiscal policy measures without endangering the public finances. In the first place, such measures can help to limit the increase in unemployment, reduce the risk of unemployment becoming entrenched and mitigate the consequences for particularly vulnerable groups.

- The measures of stabilisation policy shall be constructed so that they are not liable to prevent net lending from returning to a level in line with the surplus target when resource utilisation normalizes. Experience illustrates that once certain temporary measures of stabilisation policy have been introduced, it can be politically difficult to reverse them. Such measures should therefore be avoided. To ensure that stabilisation policy does not itself become a source of more long-term problems for the public finances, the premiss must be that, if temporary measures are taken, one must make sure that they will in fact be temporary.

- If permanent measures are taken to mitigate an economic downturn (this presupposes that there is room for such measures), they should in the first place be measures that contribute in time to lasting increases in employment and GDP.

Government intervention in the financial markets

- Efficient financial markets are also crucial for a stable macroeconomic development, as well as for an effective stabilisation policy. For government intervention in the financial markets to be effective, it is important in the event of such intervention to have a clear allocation of roles among authorities and clear principles for how the public finances are to be safeguarded.

- Financial crises can make it necessary for the Government to take special measures to promote financial stability and thereby prevent the crisis from having marked effects on the entire economy. If the Government needs to take such measures, the starting point is to limit the consequences for the public finances. It is important that any losses are born in the first place by the credit institutions themselves, above all their shareholders, and others who have contributed venture capital. This also reduces the problems connected with credit institutions taking undue risks.

Oppenness and clarity

- The direction of economic policy and budget policy in the years ahead is normally presented in the Spring Fiscal Policy Bill. The practice is for the Government to present its assessment of the current economic situation as well as the challenges for structural, stabilisation and redistribution policy, calculate an appropriate expenditure ceiling for the third year to come, follow up the budgetary goals, and assess the room for reform or the need for consolidation measures. It is also the practice for the Spring Fiscal Policy Bill to include a separate account of redistribution policy and an assessment of the public finances' long-term sustainability.

- The Budget Bill contains the Government's specific policy proposals, above all for the coming budget year, as well as proposals for the expenditure ceiling for the third year ahead. An account of economic equality is also presented.

- The Government's Annual Report contains an evaluation of the past budget year as regards the budget and fiscal policy's goals.

- Both the Spring Fiscal Policy Bill and the Budget Bill contain forecasts for the coming 3–4 years. The best available methods are to be used for the forecasts. Effects on GDP, employment and income distribution are to be estimated for measures that are assessed to have a sizeable macroeconomic impact. Forecasts and estimates of effects are to be based on data of the highest possible quality and have their starting-point, wherever possible, in the current state of research.

- The assessments of the public finances' long-term sustainability are to be supplemented at regular intervals with generational analyses. Long-term surveys are also to be produced at regular intervals; they are an important foundation for the analysis of challenges that fiscal policy faces in the future.

1 The document's purpose

Since the economic crisis in the early 1990s Sweden has made a number of major institutional changes in monetary as well as fiscal policy. Monetary policy has been delegated to an independent central bank (the Riksbank) with the aim to achieve low, stable inflation, and thereby, a stable economic development as well. A fiscal policy framework has been introduced stepwise over time in order to improve the conditions for fiscal policy's long-term sustainability.

In order to strengthen the fiscal policy framework, the Government took a number of measures during its previous term in office. The expenditure ceiling and the surplus target were made obligatory in 2010. In 2007, the Government set up a fiscal policy council as a part of the work of making fiscal policy more transparent and improving external monitoring and evaluation. The Government has also improved the presentation of fiscal policy in the fiscal policy bills. In the 2008 Spring Fiscal Policy Bill, the Government clarified how the room for reform, or the need for consolidation measures is determined with reference to the fiscal policy framework (prop. 2008/09:100). In the same bill the Government also clarified its view on the allocation of roles in stabilisation policy and the principles for conducting this policy. Moreover, the Government has taken steps to improve the presentation of new reforms' estimated effects, for instance on GDP, employment and income distribution. Furthermore, the Government has improved the presentation of how fiscal policy's long-term sustainability is assessed. Guidelines for tax policy were presented by the Government in the 2009 Spring Fiscal Policy Bill (prop. 2008/09:100), and they have been commented on in subsequent budget bills. In the 2010 Spring Fiscal Policy Bill (prop. 2009/10:100), the Government clarified the motives behind the surplus target and the target's level in the light of these motives. Besides this, the Government has improved the internal drafting procedures in the Government Offices with a view to making the budget process even more robust.

There is cause to continue the efforts to strengthen the fiscal policy framework. The academic literature recommends that fiscal policy to a greater extent should draw lessons from the work that several central banks, including Sweden's, have done in the past decade to clarify the principles that underlie the conduct of monetary policy.[1] The background here is that research and practical experience have shown that greater transparency in monetary policy and an understanding of how central banks act lead to a more effective monetary policy. Confidence that monetary policy will achieve its goals is created by households, firms and financial markets being in a position to foresee how central banks will act and the effects of their actions. There are good reasons for believing that the same applies to fiscal policy. This document represents a step towards a further improvement in fiscal policy's transparency. Its

[1] See e.g. Leeper, M. (2009) "Anchoring Fiscal Expectations", CAEPR Working Paper No. 015-2009. For an example of how monetary policy has been clarified, see Sveriges Riksbank (2010), Monetary Policy in Sweden.

primary purpose is to summarize the fiscal policy framework, and thereby enhance confidence that the construction of fiscal policy is sustainable in the long run and is presented transparently. Another purpose is to specify certain aspects of the framework and its implementation.

Provided that there is broad political support for the fiscal policy framework, it contributes to less uncertainty about the future conduct of fiscal policy, at least regarding those aspects of fiscal policy to which the framework applies. This also makes future fiscal policy less uncertain in the event of a change of government. In that way, the framework can contribute to a more stable macroeconomic development and reduce the risk of fiscal policy being a source of instability. The fiscal policy framework is also intended to strengthen the credibility of Sweden's compliance with the EU's Stability and Growth Pact and the forthcoming EU Directive on national budgetary frameworks.

Several components of the fiscal policy framework are already regulated by provisions in the Instrument of Government, the Riksdag (Swedish Parliament) Act, the Local Government Act (1991:900) and the Budget Act (2011:203). To indicate the components that are regulated by law, the relevant sections of the law are cited in this text. Other parts of this document can be seen as an institutionalisation of aspects of the fiscal policy practice that has developed gradually over time since the mid-1990s. The document accordingly constitutes a summary of statutory rules and practice. Compliance with the fiscal policy framework will be continuously monitored by the Government in the Spring Fiscal Policy Bill and the Government's Annual Report.[2]

The fiscal policy framework is intended to function as a steering-oar for fiscal policy. However, new experience and new conditions for policy may mean that the way policy is conducted needs to be developed over time. The fiscal policy framework may also need to be extended to other aspects of fiscal policy than those which are covered in this document. The document's content will therefore need to be revised roughly once in every term of office. Such revisions shall be accompanied by a clear account of how they have been done and for what reasons.

2 The fiscal policy framework's role in the political decision-making process

There are good reasons for making fiscal policy more transparent and in doing so learn from monetary policy. At the same time, the considerable differences between the two policies mean that the accounts of the principles on which their conduct is based will also differ in essential respects. The decision-making process for fiscal policy is much more extensive and complex than it is for monetary policy. The main reason is that fiscal policy has more goals and instruments than monetary policy, which means that, unlike the case with monetary policy, it is neither

[2] This will be done as of the 2012 Spring Fiscal Policy Bill.

possible nor desirable to transfer fiscal policy decisions from the political system. The fiscal policy framework is intended to help ensure that, with respect for the necessity of being able to adapt fiscal policy to current conditions, the Riksdag's fiscal policy decisions are not unduly focused on the short term. The general objectives of fiscal policy are described in the following together with the fiscal policy framework's role in the political decision-making process.

2.1 The general objectives of fiscal policy

The overall objective of fiscal policy is to create as much welfare as possible by promoting high and sustainable economic growth and employment, welfare that extends to everyone, and stable resource utilisation. An important condition for attaining these goals is the public finances' long-term sustainability. Without long-term sustainability, the financial markets, households and firms will lose confidence in the public sector's ability to meet its commitments.

2.1.1 Structural policy objectives

One of the joint goals for economic and fiscal policy is higher long-term growth. That is achieved with a well-designed structural policy that, for example, creates good incentives for work and enterprise. High employment, besides contributing to high production capacity, reduces individuals' and society's costs for alienation and exclusion. A high number of hours worked is also a precondition for being able to finance the public sector's commitments without imposing an unduly heavy tax burden on the working population. A growing proportion of elderly people makes this particularly important. Structural policy shall also be used to promote a high increase in productivity and to correct market failures in certain fields, for example the environment and health. Economic growth shall be sustainable, which means that it is to be achieved without unacceptable effects on the environment, the climate or people's health.

2.1.2 Redistribution policy objectives

Another policy objective is to improve general welfare for everyone. This is achieved with *redistribution policy*, whereby everyone benefits from GDP growth. Redistribution policy acts through the system of taxes and transfers, that leads to a more uniform distribution of disposable incomes, and also through subsidizing public services such as health care and child care. Redistribution policy also reallocates income over people's lifetimes, for instance by means of the old-age pension system.

2.1.3 Stabilisation policy objectives

Fiscal policy shall also, when necessary, contribute, via *stabilisation policy*, to economic stabilisation. Large cyclical fluctuations are costly on account of their negative effects on investment, productivity and employment. As large investments generally cannot be cancelled, uncertainty about the economic future tends to discourage them. Moreover, a major economic downturn eliminates productive capital (machinery and buildings) when companies go bankrupt. Periods of high unemployment are liable to reduce the competence and thereby the productivity of those who lose their jobs. In time that can lead to permanently higher unemployment. Furthermore, large fluctuations in economic activity and the rate of inflation make it more difficult for households and firms to make rational decisions.

2.1.4 Sustainable public finances

Fiscal policy's credibility among citizens, firms and the financial markets requires that the public finances are sustainable in the long term. A fiscal policy which lacks long-term sustainability leads to increasing public debt, with a risk that fiscal policy need to focus on debt reduction rather than on measures promoting growth, welfare and employment. Sweden's experience from the crisis in the early 1990s and the present severe situation for government finances in many European countries are examples of this.

The public sector's finances are usually said to be sustainable if they meet the public sector's inter-temporal budget restriction. It states that the initial (current) public net debt, expressed as a percentage of GDP, shall be covered by the present value[3] of all future annual primary net lending. In practice, however, the inter-temporal budget restriction can be met in various ways, some more preferable than others. For instance, the restriction is met when current generations incur large debts that will be financed by future generations; such an arrangement entails a lack of justice between generations. Alternatively, large deficits over a limited period can be financed with future tax increases, but that would impair economic efficiency. Another way of meeting the inter-temporal budget restriction could be to finance high initial debt via higher inflation or greatly increased risk premia that reduce the value of outstanding government bonds. Experience shows that in the great majority of cases such financing leads to large and lasting economic problems.[4] The Government's standpoint is that fiscal policy is sustainable if it is constructed in such a way that the inter-temporal budget restriction is met without this entailing generational injustice, a need of future tax increases, higher inflation, or larger risk premia.

[3] "Present value" indicates that the calculation allows for money being worth less in the future than it is today.
[4] The inter-temporal budget restriction is discussed more fully in a departmental memorandum (Ds 2010:4).

2.2 The fiscal policy decision-making process and the importance of democratic control

Fiscal policy has several different goals and instruments, which means that conflicts between goals often arise and have to be resolved by the political system. In some cases, solutions can be found that favour every goal or at least do not create conflicts between them. In many other cases, some goals have to be given priority over others, which requires political deliberation.

Under these circumstances, fiscal policy's various goals cannot be treated one by one. Stabilisation policy cannot be separated from redistribution policy. When the Government proposes measures of stabilisation policy, aspects of redistribution policy must also be taken into account. Some stabilisation measures may be preferable over others taken into account also distributional goals. Neither can stabilisation policy be separated from structural policy. In certain situations, for example, there can be grounds for implementing structural reforms earlier than otherwise if they promote stabilisation in the current economic situation. Similarly, redistribution policy cannot be entirely separated from structural policy. The construction of redistribution policy must, for example, consider the incentives for work and economic growth. In other words, political decisions require trade-offs and priorities. There is no simple or clear-cut way of doing this. The trade-offs and priorities that any government is bound to make are incorporated in the assessments and proposals which the Government presents to the Riksdag. Thus, fiscal policy decisions involve a variety of trade-offs and priorities. At the same time, fiscal policy is normally decided trough negotiations, meaning that the final outcome is not infrequently a result of compromises. Consequently, fiscal policy decisions cannot be mechanical or described in all their parts in terms of a set of principles. Still, since the crisis for the public finances in the 1990s, there has been broad political agreement about the importance of sound public finances and how the budgetary framework is to be used to ensure this. Moreover, there is a high degree of agreement about a number of principles for how stabilisation policy and measures directed at the financial markets should be constructed. There have been periods when this policy and such measures have been a source of both instability and problems for the government finances. It is therefore important to have clear principles in these respects. Besides those principles, there are a number of general principles for fiscal policy's openness and clarity that can contribute to greater transparency and to fiscal policy having its intended effects. All these principles constitute the fiscal policy framework.

It should be stressed that the purpose of the fiscal policy framework is not to deprive democratically elected representatives of the right to decide fiscal policy. To be legitimate, fiscal policy shall represent values. There is no alternative to political representatives when it comes to gathering up and channelling values. The political system plays a key role for mobilisation, debate, control and exacting accountability in society, as well as for voicing opinions and perceptions and combining them into holistically oriented solutions. The ability to balance and reconcile different interests in ways that are generally acceptable is

conducive to the political system's legitimacy. In a democracy it is therefore elected politicians, accountable in future elections for their decisions, who shall choose between alternative courses of action. In this way, fiscal policy decisions have a democratic foundation. In general, therefore, fiscal policy will vary depending on the parliamentary situation on which the government of the day is based. Consequently it is neither possible nor desirable to replace the political decision-making process with mechanical rules and still preserve the decisions' legitimacy. However, the political system can indeed use rules and principles to achieve long-term sustainability in the public finances.

The Government's and the Riksdag's ultimate fiscal policy decisions are thus reached by weighing together considerably more factors than the principles that make up the fiscal policy framework. But the framework does serve as a steering-oar for fiscal policy, above all with a view to making fiscal policy transparent and sustainable in the long term. The following sections describe the fiscal policy framework's components and how the framework is applied by the Government.

3 The budgetary framework

The budgetary framework is one of the fiscal policy framework's components and comprises a stringent central government budget process, a surplus target for the public sector, a ceiling for central government and premium pension expenditures and a balanced budget requirement for local governments. The budgetary framework has functioned satisfactorily under different governments.

Credible goals for budget policy make the future more predictable and strengthen the impact of policy measures because households and firms can expect that the budgetary framework will continue to be respected in the future. Credibility also requires that measures are taken to deal with any deviations from the goals. However, since fiscal policy has to make allowance for numerous factors that vary according to the circumstances, and because future budgets are always up for political negotiation, it is hard to predict exactly which measures will be taken in the event of future divergences from the budget policy goals. Nevertheless, the direction of policy that is needed to respect the budget policy goals is stated by the Government in both the Budget Bill and the Spring Fiscal Policy Bill.

The budgetary framework, its application by the Government and how in principle the Government deals with deviations from the budget policy goals are described in the following. The account begins with the background to and motives for the budgetary framework.

3.1 Motives for the budgetary framework

The budgetary framework is used in the political decision-making process to create better conditions for attaining the general objectives of fiscal policy in a way that ensures the long-term sustainability of the

public finances. Experience from earlier crises for government finances demonstrates that clear goals and restrictions for budget policy, as well as a well-designed budget process, are important for the ability to fulfil the general objectives of fiscal policy. In the 1970s and 1980s, budget policy lacked clear rules and goals, and the budget process was considerably less stringent than it is today. As a result, short-term considerations carried greater weight at the expense of long-term sustainability. An example is Sweden's expansionary fiscal policy in those decades, which in the short run pushed unemployment down below the long term sustainable level to the price of high inflation, poor competitiveness and public finance deficits. The lesson is that the political decision-making process needs a credible anchor to reduce the risk of recurrent deficits (deficit bias). Budget policy goals for fiscal policy and a stringent budget process promote sustainability in the political decision-making process. This is the background to the introduction of a budgetary framework in Sweden in the aftermath of the economic crisis in the 1990s.

After the crisis, there was broad political agreement about the importance of introducing a budgetary framework so that earlier mistakes in policy would not be repeated. This consensus is essentially intact, but there is a risk of less compliance with the rules as the memory of earlier fiscal crises fades from memory. One way of firmly anchoring budget policy to these principles is to enshrine more of the budgetary framework in law. Compilations of different countries' experience of budgetary frameworks show that frameworks, which are largely statutory are generally more effective than those which are not.[5] The central features of the Swedish budgetary framework are regulated in law.

3.2 A stringent central government budget process

A central component of the budgetary framework is the reformed process for the central government budget that was adopted in the mid-1990s. This gave the budget a medium-term context and a top-down perspective whereby expenditures are weighed against each other and any increases are examined in relation to a fiscal space that is predetermined by the expenditure ceiling and the surplus target. The process helps to prevent the sum of all budget proposals from exceeding what is compatible with sustainable public finances. The Ministry of Finance has a coordinating role and is responsible for timetables, guidelines for budget work and the processes for budget negotiations. The Ministry is also responsible for macroeconomic forecasts and assessments of the room for reforms or the need for consolidation measures.

The budget process's medium-term context makes it easier to separate discussions of the budget's total size from issues of needs and desirable expenditures. The ceiling for government spending is set by the Riksdag for at least three years ahead. Political discussions usually have a shorter

[5] See e.g. IMF (2009), "Fiscal Rules – Anchoring Expectations for Sustainable Public Finances", Staff Paper.

horizon than this. Therefore, when the expenditure ceiling is fixed for the third year, there tends to be less pressure for that year's expenditures than for spending in the coming year.

The budget process is regulated in the Instrument of Government, the Riksdag Act and the Budget Act. The Government's Spring Fiscal Policy Bill is presented to the Riksdag in the middle of April. It contains proposed guidelines for economic policy and budget policy, including an estimate of the expenditure ceiling's level for the forecast period's final year. The Riksdag's decision concerning the guidelines in the Spring Bill is then turned into specific annual budget proposals during the autumn. The actual budget work is therefore concentrated to the Budget Bill (see section 7.1).

The Ministry of Finance regularly reassesses the economic outlook and this sometimes indicates a need to adjust parts of the budget in the course of a budget year. The Government submits proposals for such adjustments to the Riksdag in connection with the Spring Fiscal Policy Bill and the Budget Bill.

3.2.1 Drafting the budget

The established routines for work in the Government Offices contribute to effective and purposeful procedures, besides ensuring that the Offices can provide the Government with functional support.

Budget work in the Government Offices is decided by the Government and its Offices without any legal regulations. The work is based on the principle of joint drafting, regulated in an Ordinance (1996:1515, Art. 13 & 15) with instructions for the Government Offices. This prescribes that a matter, which concerns the fields of more than one ministry, is to be handled in the ministry to which it primarily belongs and drafted in consultation with other ministers concerned. Matters with financial implications for the central government, or other economic consequences for the public sector, shall always be drafted with the Ministry of Finance. It is the responsibility of the Ministry of Finance to ensure that the combined result of the internal budget process is compatible with the budget policy's goals. The outcome of the Government Offices' internal budget process is to be a complete Draft Budget governed by the expenditure ceiling, the surplus target and the available room for reforms.

The budget process begins with estimating baseline expenditures[6] for the coming four years. The Ministry of Finance analyses these estimates and examines whether the calculated revenues and expenditures are such that the coming years' budget policy goals can be fulfilled. If they cannot, consolidation measures are proposed. Every ministry is responsible for providing an adequate basis for arriving at overall priorities between different parts of the public sector and between the budget's different expenditure areas, as well as for assessing the public commitment. The Ministry of Finance acts as a coordinator in this work and is responsible for the assessments' mutual consistency.

[6] Expenditure forecasts for each of the expenditure areas.

3.2.2 Principles for financing

The internal work on the Draft Budget is also governed by a number of principles for financing. These principles are important for the long-term stability of central government expenditures and follow directly from the expenditure ceiling, and the target for public sector net lending that the Riksdag has decided. The budget policy goals promote stringent financing principles on both the revenue and the expenditure side of the budget.

The main principle for budget work on central government expenditures is that increased expenditure is to be financed by cutting other expenditure. From this it follows that permanent expenditure increases are to be financed with permanent expenditure cuts, which means that temporary savings cannot be used to finance more long-term expenditure increases. Moreover, finance for a reform must be traceable to a proposed change in rules or some other specific measure. The source of financing should not include dynamic effects. However, an analysis of dynamic effects should be included in the basis for the decision.

Income from sales of state-owned assets, dividends or capital reimbursements are booked under revenue headings, which means they are not directly assigned to the financing of increased expenditure in specific activities. Income from sales of state-owned enterprises is used to pay off central government debt.[7]

3.2.3 Budgeting and accounting principles

The scope of the central government budget is regulated in the Budget Act. The Draft Budget is to include all revenues and expenditures as well as other payments that affect the central government borrowing requirement (Ch. 3, Art. 3, the principle of completeness). Moreover, central government revenues and expenditures are to be budgeted and booked gross under revenue headings and appropriations (Ch. 3, Art.). In other words, expenditures are to be booked on the expenditures side of the budget, revenues on the revenue side. Departures from gross accounting are allowed in cases where the Riksdag has decided that revenues may be used for a particular purpose by other means than a decision on appropriations (special destination). Such revenues shall not be budgeted and booked under revenue headings. This exception does not apply to tax revenues, which are invariably to be budgeted and booked under revenue headings (Ch. 3, Art. 6).

The Budget Act includes a separate rule to the effect that expenditures may not be budgeted and booked under revenue titles (Ch. 3, Art. 5). The rule concerns support that shall normally be financed from appropriations and has no connection with tax laws, either in the form of tax reductions or as part of the tax laws in other ways, but are simply booked on tax

[7] Note, however, that in the case of shares acquired under the Act (2008:814) on state support for credit institutions, sales receipts shall be assigned to the account with the National Debt Office that is a part of the Stability Fund (Bill 2008/09:61). When funds are placed in the Stability Fund, the government debt is reduced correspondingly.

accounts as credits. In the national accounts, such support is treated as expenditure.

The accounting principles are also important. The principles for different categories of revenues and expenditures are set down in the Budget Act (Ch. 4, Art. 2 & 3). On the revenue side, income from taxes and charges is to be booked under the revenue heading for the budget year to which they refer, i.e. the relevant tax year. Other income shall be booked under the revenue heading for the budget year to which they refer, i.e. the accounting or invoicing date. On the expenditure side, transfer outlays are to be assigned to the budget year in which payment occurs, administrative expenditures to the budget year in which the costs are incurred and other expenditures to the budget year to which they refer, in practice the year they are invoiced or similar. The cash accounting principle for transfers is applied as a rule so that transfers are paid out in the year to which the support refers. Departures from this principle may be necessary under exceptional circumstances, in which case the Government should motivate them.

3.2.4 Budget procedures in the Riksdag

The Riksdag Act (Ch. 5, Art. 12) requires that the Riksdag's model for drafting and deciding the central government budget shall have a clear top-down profile. In the first stage the Riksdag decides expenditure frameworks for the 27 expenditure areas the Riksdag has laid down, as well as an estimate of budget revenues. These matters are drafted by the Finance Committee, which collects opinions from other standing committees in the course of this work. Thereafter the Finance Committee drafts a comprehensive proposal for the Riksdag to vote on.

In the second stage, the standing committees consider the appropriations for the various expenditure areas. The expenditure frameworks that were decided in the first stage act as a binding restriction in stage two. This means that an increased appropriation in a particular expenditure area can now be proposed only if it is balanced by reducing another appropriation in the same area.

3.3 The surplus target

After three years of phasing in, a target for public sector net lending was introduced in 2000. The Budget Act requires the Government to propose a target for public sector net lending (Ch. 2, Art. 1) as well as to report how the target is fulfilled to the Riksdag at least twice in a budget year (Ch. 9, Art. 2). The reports are normally included in the Spring Fiscal Policy Bill and the Budget Bill, as well as in the Government's Annual Report. The Riksdag has decided that the surplus target is to be 1 per cent of GDP as an average over a business cycle, measured in terms of general public sector net lending.[8] The present level of the surplus target

[8] To begin with the target was 2 per cent of GDP. When Eurostat decided that as of 2007 saving in the premium pension system could no longer be included in financial saving, the

is to be maintained during the current term of office and for as long as is necessary for a sustainable long-term development of public finances.[9]

3.3.1 Motives for the surplus target

The motives for the surplus target are that it shall contribute to[10]:

1. The long-term sustainability of the public finances so that citizens, firms and financial markets have confidence in fiscal policy.
2. Adequate margins for avoiding large deficits during economic downturns even in connection with an active contracyclical policy. The surplus target contributes to a buffer being available for countering sharply falling economic activity without risking an unsustainable increase in debt.
3. A uniform distribution of resources between generations. In Sweden, as in many other countries, the proportion of elderly people in the population will become appreciably larger in the coming decades. Relatively high medium-term public saving during demographically advantageous years means that the large cohorts which will need medical care and social services in the years ahead are themselves contributing to the financing of these services.
4. Economic efficiency. The surplus target promotes economic efficiency by providing better conditions for a tax take which does not have to be increased, and does not vary over time on account of demographic changes.

The long-term sustainability of the public finances is an essential restriction for fulfilling the surplus target's other motives. Without long-term sustainability, the financial markets, households and firms will lose confidence in the public sector's ability to fulfil its commitments. That in turn leads to a process whereby government borrowing becomes hard, or very expensive.

Moreover, experience from the financial crisis that began in 2008 provides good grounds for ensuring that the surplus target contributes to the existence of a buffer for countering marked economic downturns without risking an unsustainable increase in debt. Experience also shows that, during sizeable global downturns and international financial market unrest, it is often small, open economies with their own currency, which are particularly exposed. In such situations, room to manoeuvre in fiscal policy, in form of a surplus in line with the target and a low debt ratio, imparts political strength. The Government attaches great importance to this motive for the surplus target.

surplus target was technically adjusted, from 2 to 1 per cent of GDP. See prop. 2006/07:100, bet. 2006/07:FiU20, rskr. 2006/07:220.

[9] Prop. 2009/10:100, bet. 2009/10:FiU20, rskr. 2009/10:387.

[10] See prop. 2009/10:100, section 4.

Given that great weight is attached to the surplus target, ensuring that net lending provides a buffer for countering major economic downturns without risking a rapid increase in debt, the surplus target should be largely forward-looking. Stabilisation policy's potential is also bound up with the debt ratio. As a rule, a high debt ratio makes stabilisation policy less effective. With the present state of Sweden's public finances, however, with a relatively low debt ratio, the main thing is to avoid a situation with large deficits and the associated risk of rapidly growing government debt, rather than aiming for a particular level of debt at a given time.[11] Of course the level of debt has to be taken into account in assessments of the surplus target's appropriate level.

As regards the surplus target's contribution to a uniform intergenerational distribution of resources and economic efficiency, the target can only serve to manage the part of the increase in the proportion of elderly people that is due to *temporary* changes in the size of age cohorts; it cannot be used for the long-term management of an upward trend in public financial costs that reflects rising life expectancy. Neither can the surplus target be used for long-term pre-financing of future demands for a higher quality of welfare. Such increments to costs must be financed by future generations, not least because economic growth will give them a higher level of welfare. [12]

As the surplus target is motivated in several ways, its appropriate level may have to be adjusted in the light of the relative importance that is attached to the various motives. The target's level needs to be analysed from time to time to ensure that the chosen level supports the target's explicit motives. At the same time, the effectiveness of the target requires that this type of appraisal does not occur too frequently.[13]

3.3.2 Principles for assessing deviations from the surplus target

It is important to have clear principles for evaluation of the surplus target. As the surplus target is primarily a forward-looking anchor for fiscal policy, whereby a room for reform or a need for consolidation measures is determined, compliance is checked in the first place from a forward-looking perspective. A backward-looking analysis is also made, however, to detect the occurrence of systematic faults in fiscal policy, which might lower the probability of target compliance in the future. If systematic deviations result in a markedly altered debt ratio, the level of the target and its implementation may also need to be reassessed.

[11] A relationship exists between net lending and net debt. Assuming constant net lending and no changes in the value of net debt, net debt, measured as percentage of GDP, converges on a certain point. That means that positive saving in the form of a surplus target does not imply an increase in the GDP share for public assets. Given a surplus target of 1 per cent and 5 per cent nominal GDP growth, in time, the public sector's net financial assets will approach and fluctuate around 20 per cent of GDP.

[12] See section 12 in the 2010 Spring Fiscal Policy Bill (prop. 2009/10:100).

[13] The Ministry of Finance made such an appraisal in 2010 (Ds 2010:4). In the 2010 Spring Fiscal Policy Bill the Government assessed that at present there are no substantial conflicts between the stated motives for the surplus target.

The reason why the surplus target is formulated as an average over a business cycle rather than as 1 per cent of GDP annually has to do with stabilisation policy. If the target were to be net lending at 1 per cent of GDP in every year, when economic activity slackens, fiscal policy would have to be tightened in order to fulfil the target. Policy would then accentuate cyclical fluctuations. Moreover, the automatic stabilisers would not be left to act freely (see section 5.2). At the same time, a target formulated as an average over a business cycle makes it more complicated to assess whether or not fiscal policy is in line with it because one then has to look not only at actual net lending but also at how this has been affected by the economic situation. When resource utilisation is high, for example, the room for reform in relation to net lending will be exaggerated compared with what normal resource utilisation would indicate. In other words, surpluses that are large because economic conditions are particularly favourable are not to be used to finance permanently increased expenditures or tax cuts. Similarly, average net lending would be too high if the surplus target had to be met even in years when the economy is markedly weak. This means that the economic situation has to be taken into account when compliance with the target is assessed and the room for reform or a need of consolidation measures is determined. However, there is no single method that can yield a precise measure of the economic situation and hence of target fulfilment. Nonetheless, the economic situation has to be taken into account in an evaluation of target compliance. The Government therefore monitors target fulfilment with the aid of a set of indicators.

A set of indicators is used to monitor the surplus target

To detect any systematic defects in fiscal policy that might lower the probability of future compliance with the surplus target, the Government uses a *backward-looking* moving ten-year average of net lending. Thus, this indicator represents the average level of net lending in the most recent ten annual outcomes. The interpretation of this average also takes the average economic situation in this ten-year period into account. Net lending, which on average in such a ten-year period, is close to 1 per cent of GDP, at the same time as the period's average resource utilisation was normal (measured as the average GDP gap being close to zero), indicates that there have been no serious systematic faults in fiscal policy.

For the *forward-looking* evaluation of the surplus target, the Government uses two indicators; a measure of the structural budget balance (measured in terms of net lending) and a moving seven-year average of net lending. The structural budget balance aims to indicate how large net lending would be in a normal economic situation.[14] A

[14] When calculating the structural budget balance, net lending is adjusted for the economic situation as well as for sizeable one-off effects and extraordinary levels of households' capital gains. The Ministry of Finance currently develops a new method with a view to enabling the calculation of the structural budget balance to allow for different types of cyclical shock having different impacts on net lending.

positive structural budget balance (above 0 per cent of GDP) implies that there is a permanent underlying surplus in the public finances regardless of the economic situation. A structural budget balance close to 1 indicates that net lending is at the targeted level the year in question. The seven-year indicator is a centred seven-year average of net lending. For a given year, this indicator comprises net lending in that year, in the three preceding years and in the following three years.[15] The structural budget balance relates net lending to the target in a given year, while the seven-year indicator shows how net lending relates on average to the target over the seven years in question.[16]

The monitoring of target compliance is based on an overall assessment

In that the cyclical position of the economy cannot be determined exactly, the monitoring of target compliance has to be based on various indicators, and on an overall assessment. In doing this, the Government also includes some other factors, above all the uncertainty of the assessment and the risk spectrum.

The assessment's uncertainty: Forecasts of actual net lending are highly uncertain; in the period 2000–2006 the annual errors averaged almost 2 per cent of GDP. This also means that the calculations of the structural budget balance and the seven-year indicator are very uncertain. Moreover, outcome figures are not available for the structural budget balance. The structural budget balance can be calculated in a variety of ways, but the results are liable to differ across methods. In addition, the picture of the previous years' structural budget balance may have to be revised, often due to a revision of resource utilisation (the GDP gap). In the period 2000–2006, for instance, the revisions of the structural budget balance between the first and the latest assessments for any given year averaged 1.2 per cent of GDP; for some years in this period the revision amounted to several percentage points.

The risk spectrum: The Government's assessment of departures from the surplus target in the forecast period also take into account the risk spectrum. One of the problems when assessing to what extent public sector net lending is affected by the economic situation is that business cycles may be asymmetric. In that case, the deficits that arise during a economic downtown may not be balanced by the surpluses during the subsequent boom. This factor is therefore included in the Government's overall assessment of target compliance.

All this indicates both the importance of incorporating a variety of factors in the evaluation of target compliance and that such an assessment should not be mechanical. A considerably simpler and thus more mechanical approach could lead fiscal policy seriously astray. In its overall assessment of target compliance, however, the Government's starting point is to present as clear a picture as possible of the factors

[15] The seven-year indicator is also adjusted for sizeable one-off effects and extraordinary levels of households' capital gains.

[16] See the 2011 Budget Bill (prop. 2010/11:1, section 4) for a fuller account of these indicators, their motivation and their implementation in practice.

taken into account. A transparent account facilitates external scrutiny of this assessment.

3.3.3 Principles for dealing with target deviations

If the surplus target is to function as an anchor for fiscal policy, deviations, if any, must be corrected. As indicated above, this cannot be done mechanically. Still, the Government does apply a number of principles for how target deviations should be managed, depending on their magnitude and the economic situation. The principles for how the Government handles the potential conflict between the surplus target and the goal that fiscal policy shall not be procyclical, are described below. Note, however, that in practice fiscal policy often has to take other considerations into account besides economic stability. The questions of when and how a deviation is to be corrected must be based on an overall assessment in which stabilisation, redistribution and structural policies are all taken into account. The following description should therefore be seen primarily as an outline (see also sections 2.1 and 5.2).

Considering the great uncertainty in forecasts of public finances, it would not be reasonable for minor deviations from the target to occasion policy realignments. That would give policy an undesirable stop-go element. But even if the deviation in a particular budget year is small, measures may be called for if the deviation is forecast to grow considerably in future years. As the surplus target does not aim for a certain level of debt by a given date, minor deviations are not a problem in themselves, provided they do not all move in the same direction. However, this uncertainty must not be used systematically to create room for unfinanced reforms.

In an assessment of when deviations should be corrected, it is important to allow for the business cycle. If, for example, net lending is assessed to be permanently above the surplus target and should therefore be lowered by cutting taxes or increasing expenditures, it may be inappropriate to do this in years when economic activity is strong. A strict interpretation of the goal that fiscal policy is not to be procyclical (see section 5) implies that a level of public saving which is assessed to be permanently above (below) the surplus target cannot be corrected before the next economic downturn (upswing). This goal needs to be elaborated on, however; Assume that public saving is assessed to be permanently above the surplus target. Even if an economic downturn is not foreseen in the near future, some reduction of net lending should be feasible. It must then be clear that the effects on demand will not be too great for monetary policy to handle (see section 5). The appropriate size of the reforms will depend on the current economic situation, the extent to which net lending is estimated to exceed the target, the reforms' effects on demand, and their profile over time. An additional consideration is whether the intended measures are structurally appropriate, i.e. the extent to which they can be expected to improve the functioning of the economy. The following figure summarizes the conflicts between goals that fiscal policy may encounter when the

cyclical situation is taken into account in the correction of a deviation from the surplus target.

Correcting surplus target deviations with allowance for the business cycle

Assessed surplus target compliance

Resource utilization	*Above the target*	*On target*	*Below the target*
High	Balance-weakening measures when the economy slackens	No measures	Balance reinforcement at a high rate
Nor-mal	Balance-weakening measures at a moderate rate	No measures	Balance reinforcement at a moderate rate
Low	Balance-weakening measures at a high rate	No measures	Balance reinforcement as the economy recovers

If public sector net lending is assessed to be permanently above (below) the surplus target and resource utilisation is low (high), measures to weaken (reinforce) the balance can be implemented at a relatively high rate, which as a rule also leads to more balanced resource utilisation. In this context, consideration is also paid to whether or not the spectrum of risks around the forecast is symmetric. If a sizeable weakening of the balance is called for, spreading it over several years can be preferable if the economic situation warrants this.

On the other hand, when resource utilisation is assessed to be normal and public sector net lending's target deviation is persistent, measures should be taken more gradually. A more expansionary policy may be justified if the reforms are structurally appropriate. But if public sector net lending is permanently above (below) the target when resource utilisation is high (low), reforms that weaken (reinforce) the balance should be largely deferred until economic activity slows (recovers).

The above figure is a simplified picture of different decision-making situations. In practice, other circumstances than those shown in the figure may also need to be included in the assessment of how target deviations should be managed in a particular situation. For example, the economy can be hit by cyclical shocks that are asymmetric, whereas the figure presupposes they are symmetric. When net lending is assessed to be permanently below the surplus target and the economy is weak, the figure assumes that necessary consolidation measures can wait until the next cyclical upswing so that fiscal policy does not exacerbate the economic downturn. However, in practice another negative shock can hit the economy before resource utilisation has returned to normal, in which case the goal of avoiding a procyclical fiscal policy must be weighed against the risk of public finances not being perceived as sustainable in the long run. Such a situation can motivate budget reinforcements even though resource utilisation is low.

Note also that the figure is primarily intended to describe the conflicts between goals that can arise in connection with initial deviations from the surplus target, given that fiscal policy shall normally not be procyclical. Even when net lending is in line with the target initially,

stabilisation policy can motivate a *temporary* deviation from the target. It is important, however, that stabilisation policy is based on clear principles so that deviations from the target for other reasons are not motivated with reference to stabilisation policy. The principles for stabilisation policy are considered in section 5.

3.4 The expenditure ceiling

The expenditure ceiling was introduced in 1997. The Budget Act stipulates that the Government in the Budget Bill shall propose an expenditure ceiling for the third year ahead. The ceiling is then decided by the Riksdag. If an approved expenditure ceiling is liable to be exceeded, the Act requires that, to avoid this, the Government is to take measures to which it is entitled, or propose necessary measures to the Riksdag (Ch. 2, Art. 4).

The expenditure ceiling's coverage is not regulated in law. In principle, however, all the ceilings to date have had the same coverage. The established practice is for the ceiling to apply to expenditure areas 1–25 and 27 plus the off-budget expenditures for the old-age pension system. The ceiling does not include expenditure area 26 Central Government Debt Interest, etc. Together with local government expenditures, the items covered by the ceiling comprise almost the whole of the public sector's expenditures. The expenditure ceiling is fixed in nominal terms, which makes evaluation transparent and simple. Moreover, a nominal ceiling gives less incentives for the government trying to increase inflation.

It has become the practice not to amend the expenditure ceiling. The ceiling's cap on central government expenditure is to be unchanged from when the ceiling for a given year is fixed until that year has ended. The ceiling has been altered on just a few occasions, due to changes in the direction of budget policy; it was lowered in every case. This happened, for example, after the change of government in the autumn of 2006, when the previously decided ceiling for 2007 was lowered by SEK 11 bn.

There are no formal obstacles to the Riksdag deciding to reassess an established ceiling (bet. 1995/96:FiU10). If there were, a new government's possibility of adjusting fiscal policy would be greatly restricted; neither could policy be adapted to completely changed conditions. In addition, there may be grounds for altering an established ceiling in connection with technical budget rearrangements so that the limiting effect of the expenditure ceiling remains the same (see section 3.4.2).

The central government budget process has a clear medium-term, top-down perspective (see section 3.2). The expenditure ceiling is the overriding restriction on the budget process in terms of aggregate expenditure. From that the ceiling is decided for the third year ahead, until that year has passed, the need to establish priorities between different expenditures is underscored. The medium-term perspective lessens the risk of temporarily high revenues (e.g. in good years) being used to finance permanently higher expenditures. That in turn limits the

risk of fiscal policy having a destabilising (procyclical) effect from the expenditure side.

The expenditure ceiling is a central commitment for budget policy that promotes budget discipline and strengthens economic policy's credibility. One of the ceiling's primary functions is to provide conditions for the public finances' long-term sustainability. Moreover, the ceiling's level should promote a desirable long-term development of central government expenditures. In combination, the surplus target and the expenditure ceiling govern the total tax take and help to prevent a situation where insufficient control of expenditures necessitates an, over time, increasing tax take.

3.4.1 The expenditure ceiling's level

The proposed expenditure ceiling manifests the complex relationship between, on the one hand, the Government's possibility, with the Riksdag's support, of implementing the policy for which it has been elected and, on the other, the need for budget rules which help to ensure that the policy's long-term effects on the public finances are taken into account in the political process.

The ceiling's level represents the Government's appraisal of how public commitments should develop. The composition of expenditures as well as the central government sector's aggregate turnover and hence the requisite tax take reflect the ideological values on which policy is based. That makes it reasonable for the level of the ceiling to be decided by the Riksdag. At the same time, the ceiling's rationale is to largely separate the discussion about how much room exists for central government expenditures from the discussion of which expenditures are necessary or desirable. A meaningful limit to expenditure has to start in some way from an overall concept of how the public sector should relate to GDP. Since in the long run it is the level of the expenditure ceiling that determines the total tax take, the level should be decided so that it corresponds with the view of how large a reasonable tax take can be without incurring excessive macroeconomic costs.

The Government's reasoning behind the proposed level of the expenditure ceiling for a given year is made evident if the level is motivated by demonstrating how the ceiling relates to other macroeconomic factors and how the ceiling serves to fulfil the surplus target and an acceptable level of the total tax take. Examples of determinants which the motivation can include are:

- the expenditure ceiling in relation to the surplus target,
- the development of the expenditure ceiling and total public expenditures in relation to GDP,
- the development of the capped expenditures and the size of the budgeting margin over time, and
- the development of the capped expenditures at constant prices.

3.4.2 Technical adjustments of the expenditure ceiling

Each decision on a new expenditure ceiling defines that ceiling in a certain way in relation to the capped expenditures, both as regards the expenditures to which the ceiling applies and how these expenditures are booked in the central government budget. Once the ceiling for the third year ahead has been decided, the ceiling's limiting effect on central government expenditures is to be unchanged for the year in question.

Over such a long period, however, various budgetary changes normally occur that alter the level of the capped expenditures without a corresponding change in the total public sector commitment. Conversely, changes can be made (e.g. decisions about crediting tax accounts) that affect the public commitment but for technical reasons do not alter the capped expenditures. In order to maintain the expenditure ceiling's original financial stringency and keep the ceiling in line with the surplus target, its level therefore has to be adjusted so that budgetary changes of this kind are neutralized.

The aim of technical adjustments is that the expenditure ceiling's limiting effect on public expenditures shall be as stringent after as before the changes that occasioned the adjustment. A technical adjustment of the ceiling shall be done if the relevant budget change has a net effect on the consolidated public sector's expenditures or on public sector net lending that differs from its effect on the capped expenditures. Technical adjustments have been made on several occasions since the ceiling was introduced in 1997 (see e.g. prop. 2010/11:1). The Government bases technical adjustments on a number of principles:

- Technical budgetary rearrangements that do not effect public commitment (e.g., switching from gross to net accounting or vice versa) should occasion technical adjustments whereby a fixed expenditure ceiling is as stringent as originally intended in relation to public sector net lending. This applies irrespective of whether the net accounting occurs on the budget's expenditure side (e.g. predetermined use of revenue) or on the revenue side (e.g. crediting expenditure to a taxpayer's tax account).[17]

- Technical adjustments should be done irrespective of whether they raise or lower the expenditure ceiling.[18]

- Changes that affect the public commitment, but not the capped expenditures (e.g., a reform with new expenditures that are credited to a taxpayer's tax account) should occasion technical adjustments whereby the stringency in relation to the public commitment remains as originally intended.

[17] See prop. 2010/11:40.
[18] See prop. 2009/10:5.

3.4.3 The size of the budgeting margin

The gap between the expenditure ceiling and the capped expenditures is the budgeting margin, which is to function in the first place as a buffer if economic developments cause expenditures to differ from the original estimates. The Government's guideline is that the budgeting margin should amount to at least 1 per cent of the capped expenditures in the current budget year, at least 1.5 per cent for year t+1, at least 2 per cent for year t+2, and at least 3 per cent for year t+3.[19] At the same time, the margin for the third year is not to be so large as to prevent the expenditure ceiling from acting as a reasonable constraint on expenditures.

The expenditure ceiling does not constitute an expenditure target. However, as the need for a buffer decreases over time, the budgeting margin can gradually be used for expenditure reforms and other purposes that are not a consequence of cyclical developments. This presupposes that the changes in expenditures are compatible with the surplus target.

3.5 The balanced budget requirement for local governments

In order to strengthen budget processes at the local level, since 2000, local governments are required to balance their budgets (Local Government Act, Ch. 8, Art. 4). Every municipality and county council is to budget revenue so that it exceeds budgeted expenditure. A local government may budget for a temporary deficit under special circumstances, e.g. if it has a strong financial position or if measures in one budget year entail costs but promote future cost cutting or sound economic management. The assessment of what constitutes special circumstances has to be done from case to case. If a local government ends a year with a deficit, the main rule is that the deviation must be corrected within three years (Ch 8, Art. 5a). The municipal or county council may decide not to correct a deficit if it was planned when the budget was decided, if unrecoverable losses have occurred on securities or in the event of other special circumstances (Ch. 8, Art. 5b). Correcting just a part of a deficit and taking more than three years to correct it are also included in the concept of special circumstances, according to the drafting documents.[20]

The balanced budget requirement is a minimum requirement. The Local Government Act stipulates that local governments also are to practice sound economic management. The drafting documents present some guidance.[21] In the normal case the financial result in real terms should at least consolidate the economy, including, e.g., pension

[19] The guideline for the size of the budgeting margin for the third year (the year for which the expenditure ceiling is decided) is in line with assessments in a report (SOU 2000:61) on evaluating and developing the budget process as well as an enquiry (SOU 2002:16) concerning stabilisation policy in the EMU.

[20] Prop. 1996/97:52. p. 94.

[21] Prop. 1996/97:52. p. 33.

commitments and the need for reinvestment. As of 2005, local governments are therefore required to decide the financial goals that are relevant for sound economic management. A widespread goal is that sound economic management is represented by a surplus equivalent to 2 per cent of revenue from taxes and general state grants. Local governments' annual reports are to include an account of whether the balanced budget requirement and the goals for sound economic management have been fulfilled.

The balanced budget requirement supports the surplus target. Sound local government finances help to achieve the surplus target. The Government therefore closely follows the economic development in the local government sector and includes an account in the Spring Fiscal Policy Bill and the Budget Bill.

In that the local government finances are dependent on the business cycle, there is a risk of procyclical changes in local government expenditures and taxes, contributing to accentuate cyclical fluctuations. The balanced budget requirement, in itself, can reinforce this potential behaviour by local governments. The Government has therefore commissioned an investigator to submit proposals for preventing procyclical variations in local government activities; the report is due by 15 September 2011 (dir. 2010:29).

4 External monitoring

Effective external monitoring by international as well as national bodies is important for the long-term sustainability of the public finances. International monitoring is undertaken mainly by the European Union, but also by the OECD and the IMF. National monitoring is in the hands of a number of authorities.

Like other EU member states, Sweden undertakes to abide by the rules in the Stability and Growth Pact. The most central rules are the reference values for the public budget deficit (3 per cent of GDP) and public debt (60 per cent of GDP). The member states are also obligated to set up medium-term objectices for net lending that are consistent with the requirements of the Pact. The Pact also requires that for preventive reasons member states shall annually present a stability and convergence programme that indicates how they intend to attain or maintain sound public finances in the medium term. The Commission scrutinises the programmes and the Council comments on them. If an EU country exceeds the deficit's reference level, the Council, acting on a proposal from the Commission, can start an excessive deficit procedure that includes the possibility of pecuniary sanctions on EMU participants. The Council, acting on a proposal from the Commission, can also warn a member state if its economic policy does not comply with the general guidelines or if the functioning of the EMU is endangered.

In order to strengthen the monitoring of economic policy in the EU, a new arrangement, the European Semester, has been introduced as of 2011. The main consequence is that fiscal policy (within the Stability and Growth Pact) and structural policy (within Europe 2020) will be

monitored in parallel. The primary aim is to strengthen the ex-ante dimension of the monitoring in that recommendations to member states can be more easily incorporated in their budget processes without prejudicing the role and processes of national parliaments.

Along with the European Semester, the Commission has proposed a new EU process for the supervision of macroeconomic imbalances in member states. The aim is to detect risks of member states generating major macroeconomic imbalances that could lead to problems for public finance. The supervision will be based on a list of indicators and thresholds. If the mechanism signals a warning, a closer analysis will be made of the situation in the country in question and how this affects the Union. If the imbalances are considered to be grave, the Council can activate the supervision's corrective arm. Acting on a proposal from the Commission, the Council can then start an "excessive imbalance procedure" for that country. This involves the Council issuing recommendations to the country and requiring regular reports and analyses until the member state has taken adequate measures for correcting the imbalance. Moreover, once the excessive imbalance procedure has been started, this will be weighed into the assessment of that country as regards the Stability and Growth Pact.

Furthermore, the EU produces long-term projections of the public finances in each member state to assess their long-term sustainability. This long-term sustainability is also considered in the evaluation of stability and convergence programmes.

External monitoring at the national level is likewise important for an effective fiscal policy. Sweden does not have any automatic sanctions for departures from the budgetary framework. However, in that the framework is broadly supported in the political system as well as in society, non-compliance with the rules is liable to have political consequences. Efficient external monitoring is needed to ensure that these political consequences will be considerable.

A number of Government agencies are responsible for different aspects of fiscal policy monitoring at the national level, e.g. the National Financial Management Authority, the Fiscal Policy Council, the Institute for Labour Market Policy Evaluation and the National Institute of Economic Research. The Fiscal Policy Council is specifically responsible for analysing how well the Government complies with the budgetary goals and whether the public finances are sustainable in the long term. An important starting point here is that the Council is to assess compliance with the Riksdag's goals, not the goals as such. The Government's comments on the Council's opinions are included in the Budget Bill.

The National Audit Office is an authority under the Riksdag with the task of monitoring central government activities. The Riksdag Act requires that the Government, not later than four months after receiving an assessment from the Office, shall to the Riksdag submit a statement concerning the measures the Government has taken or intends to take in the light of the assessment (Ch. 4, Art. 18).

5 Stabilisation policy

Stabilisation policy has been a source of macroeconomic instability in Sweden on several occasions in the past. In order to reduce such problems, monetary policy has been delegated to an independent central bank, the Riksbank. Moreover, a number of fiscal policy principles, based on experience, have emerged in this context. These principles are described in the following.

5.1 The Riksbank's role vis-à-vis the Government

In an economy like Sweden's, with a flexible exchange rate, monetary policy is usually considered to be more effective than fiscal policy as an instrument of stabilisation policy. In Sweden, monetary policy has been delegated to an independent central bank, the Riksbank. The Riksbank's primary objective is to maintain price stability. The Riksbank has specified this in terms of an inflation target whereby the annual change in the consumer price index is to be 2 per cent. Besides being directed to fulfil this target, monetary policy shall support economic policy's general goals with a view to achieving sustainable growth and high employment. This the Riksbank does by stabilising inflation around its target and at the same time striving to stabilise output and employment around sustainable long-term paths. The Riksbank accordingly conducts what is called a flexible inflation target policy. This does not imply that the Riksbank prejudices the supremacy of the inflation target.

Monetary policy that targets inflation while also attaching weight to stabilising real economic activity contributes as well to a balanced development in the financial markets. Experience shows, however, that even with such a policy, asset prices and private debt can sometimes develop in a way that is not sustainable in the longer run. In its interest rate decisions the Riksbank therefore also incorporates risks associated with financial market developments. In certain situations, such as the financial crisis in 2008–09, the interest rate and its future path may need to be supplemented with other measures for promoting financial stability and ensuring that monetary policy functions efficiently.

There are situations in which monetary policy may need active support from fiscal policy. Ways in which fiscal policy can and should contribute to economic stabilisation are described below.

5.2 Using fiscal policy for stabilisation

Fiscal policy can promote stabilisation in various ways: by maintaining the long-term sustainability of the public finances, by means of active measures, and via the automatic and semiautomatic stabilisers.

Fiscal policy's primary contribution to economic stabilisation lies in maintaining confidence in the public finances' long-term sustainability. Failure to do this makes it more difficult for the Riksbank to maintain price stability. The record shows that periods of high inflation are often preceded by mismanagement of the public finances. If financial markets,

households and firms lose confidence in the public finances, that will also tend to make fiscal measures for stabilisation less effective.

Active fiscal measures are those which require a specific decision, for instance to cut a tax or boost expenditure for the purpose of stabilisation. Such measures can be temporary or permanent. Permanent stabilisation policy measures presuppose that there is scope for such permanent reforms in the budget. Examples of such measures are taking structurally appropriate measures earlier than otherwise, measures that, besides contributing to stabilisation, improve the workings of the economy, and a permanently increased grant or transfer that is warranted by redistribution policy. These examples show that it is neither meaningful nor desirable to make decisions for stabilisation policy without considering the goals for structural and redistribution policy.

Fiscal policy can also help smooth cyclical fluctuations without requiring active decisions; this is because tax revenues automatically decline (increase) and expenditures for unemployment insurance and certain forms of support automatically rise (fall) in economic downturns (upswings). Such cyclically dependent public expenditures and revenues are usually referred to as automatic stabilisers.

Another form of stabilisation via fiscal policy is achieved with the semiautomatic stabilisers, which are a hybrid of active decisions and fully automatic stabilisers. They mainly consist of various measures of labour market policy; they require active decisions, but it is the rule, rather than the exception, that their volumes are adjusted to the current state of the economy.

5.2.1 When should fiscal policy be used for stabilisation?

When demand is affected by a shock, there is normally no conflict between stabilising employment and stabilising inflation. This means that in the normal case, monetary policy will stimulate the economy in downturns and restrain it in upswings. An important principle is that in such situations fiscal policy shall not make it more difficult for the Riksbank to keep inflation low and stable. Fiscal policy shall not be procyclical; in other words, it shall not stimulate demand when the economy is overheating or tend to dampen resource utilisation in a recession (see also section 3.3.3).

In the case of normal demand shocks, fiscal policy contributes to stabilisation via the automatic and semiautomatic stabilisers. When cyclical fluctuations are due to changes in demand, monetary policy will have corresponding effects on demand and inflation, so as a rule there is no cause to aim at influencing demand with active (discretionary) fiscal measures in such situations. Moreover, experience shows that considerable problems are associated with using active fiscal measures to influence demand during normal cyclical fluctuations. One reason to this is that the political decision-making process often is extended. This means that fiscal stabilisation policy measures might be implemented in the wrong phase of the business cycle. Another reason lies in the political difficulty in terminating temporary measures, which therefore tend to become permanent.

Situations do exist when fiscal policy may need to supplement monetary policy more actively. This applies in particular when economic fluctuations are due to major supply shocks (changes in the supply of goods or factors of production), so that stabilising inflation is at odds with stabilising employment. A negative supply shock, for example, leads to rising prices and falling demand, while a positive supply shock leads to the opposite. Fiscal policy may also need to supplement monetary policy when a demand shock is so great that, by itself, monetary policy cannot sufficiently check the loss of demand. This is particularly relevant when the interest rate is approaching zero per cent. Moreover, unlike monetary policy, fiscal policy has a role to play in managing specific problems that can arise in connection with an economic downturn. Examples are the reinforcement of various measures of labour market policy and dealing with consequences for redistribution policy.

It is also important that stabilisation policy is formed in the light of what caused the shock because that determines which measures are appropriate. The measures that are suitable when a shock mainly affects export industries may differ from those that suit a shock that mainly affects domestic demand. In a small, open economy like Sweden's with a flexible exchange rate, fiscal measures at home cannot prevent exports from falling in an international downturn. Still, in such a situation, the flexible exchange rate can counter the loss of export demand to some extent. The exchange rate is affected indirectly by monetary policy; an interest rate cut usually tends to weaken the exchange rate and that can tend to lessen the loss of export demand. Moreover, certain fiscal measures can mitigate consequences that an export-led shock can have in other parts of the economy. When instead the primary effect of a shock hits domestic demand, there are better possibilities of countering a loss of demand with fiscal measures.

5.2.2 Effects of stabilisation policy and the importance of safeguarding the public finances

Experience from earlier crisis management shows that fiscal measures cannot fully counteract a sharp economic downturn without tending to endanger the public finances. This is because the multipliers associated with fiscal measures (the GDP effects of a temporary fiscal measure) are usually relatively small. If the multiplier for a temporary (unfinanced) tax cut is 0.5, lowering the tax by SEK 10 bn leads to GDP being temporarily SEK 5 bn larger. The multipliers for broad measures to stimulate demand are usually assumed to lie between zero and one. The multiplier for a temporary income tax cut or temporary cash support for households can be expected to be around 0.5 or less.[22] This is partly because households will save some of the temporary addition to income and partly because some of the additional consumption consists of

[22] There is a high degree of uncertainty in these estimates; some studies point to lower multipliers, others to higher.

imported goods, which do not lift Sweden's GDP. The multipliers for public consumption and public investment are usually assumed to be greater than 0.5 but not much above 1. The effect on employment is even smaller; a common assumption is that a 1 per cent increase in GDP raises employment by ⅔ per cent. Early in the crisis that began in 2008, it was estimated that from 2008 to 2010 employment in Sweden would fall by up to 2.8 per cent, or over 120,000 persons. This meant that, given a multiplier of 1, a 4 per cent weakening of central government net lending would have been needed to fully prevent this decline in employment. With a multiplier of 0.5, the deterioration would have had to be 8 per cent of GDP.

It is important to note that the requisite weakening of net lending that these examples illustrate would occur on top of the weakening caused by automatic stabilisers. The examples show that if stabilisation policy is used to counter major economic shocks, the starting-point cannot be that the measures are to restore unemployment to entirely normal levels. Public financial vigilance sets a limit to the scale of such measures. Still, the measures can help to limit the increase in unemployment, reduce the risk of unemployment becoming permanent, and mitigate the consequences for particularly vulnerable groups.

Permanent versus temporary measures

In order to prevent stabilisation policy as such from becoming a source of longer-term problems for the public finances, the Government's precondition is that, if temporary measures are taken to counter an economic downturn, steps must be taken to ensure that they are in fact temporary. The measures of stabilisation policy are to be constructed so that they do not obstruct actual net lending's return to a level in line with the surplus target when resource utilisation normalises. As noted above, experience shows that it can be politically difficult to reverse certain temporary measures of stabilisation policy; such measures should therefore be avoided. Another precondition is that if *permanent* measures are taken to mitigate effects of a downturn, then (given that there is budgetary room for them) they should consist in the first place of measures that are structurally appropriate and help to avoid bottlenecks when the economy recovers again, besides contributing in time to lastingly higher employment and GDP. Measures aimed at creating employment (measures with a relatively low net cost per rescued/new job) should have priority over broad, short-term demand stimulation with uncertain effects on employment. In practice this means giving priority to measures aimed at relatively labour-intensive activities. However, certain measures that simply stimulate demand can nevertheless be warranted in the event of very large demand shocks. In such situations it can for example be reasonable to use measures that have just a marginal short-run impact on aggregate demand (due to a small short-run multiplier) but which in the longer run also tend to make the economy more efficient. There can also be grounds in such situations for promoting stabilisation by bringing forward permanent measures of redistribution policy that can make at least a marginal contribution to maintaining aggregate demand.

When constructing stabilisation policy it is important to bear in mind that some measures take longer to implement than others. Some matters pass through the Riksdag more quickly than others. Certain measures affect the economy sooner than others. There are also measures that can only come into force at the turn of the year.

6 Government intervention in financial markets

Functional financial markets are crucial for a stable macroeconomic development and an effective stabilisation policy. To be effective, government intervention in financial markets needs a clear allocation of roles between authorities and clear principles to safeguard the public finances in connection with such intervention.

6.1 Allocation of roles between authorities

The maintenance of financial stability is ultimately the Government's responsibility. However, the Riksbank Act (1988:1385) states that the Riksbank shall promote a safe and efficient payments system (Ch. 1, Art. 2). Moreover, the Financial Supervisory Authority supervises companies in financial markets and is to promote stability and efficiency in the financial system. The National Debt Office is responsible, when necessary, for providing loan guarantees and capital contributions to solvent banks and for managing emergency support for banks in distress. The Office is also responsible for deposit guarantees.

6.2 Principles for safeguarding the public finances in connection with interventions

Financial crises can make it necessary for the Government to take specific measures that contribute to financial stability, and thereby, prevent the crisis from having considerable economic consequences for the economy as a whole. These interventions must be seen in the light of the extremely high general economic costs that a collapse in the financial system would incur. If intervention is called for, the starting-point is to limit its consequences for the public finances. It is important that any losses are born in the first place by the credit institutions themselves, above all their shareholders and other contributors of venture capital. This also lessens the problem of institutions taking excessive risks. The government measures should therefore be designed so as to minimise the Government's long-term costs. Government outlays during the acute crisis shall be as recoverable as possible. If the Government provides a capital contribution for a credit institution in distress, the Act on State support for credit institutions (prop. 2008:814) authorizes the Government to assume temporary ownership of the institution if it is in a very weak position or does not agree to what are assessed to be reasonable conditions for the support. The Government should benefit

from any future increase in the institution's value that results from the capital contribution and the takeover. A takeover also permits a prompt reconstruction of the institution. An awareness that the Government is in a position to assume ownership and replace management, at the same time as any losses will be borne by the former owners, reduces those owners' propensity to take undue risks in the institution's operations.

While efficient supervision and regulation are of central importance, there are no guarantees that financial crises can be avoided in the future. Recipes are therefore needed for how such crises are to be managed. One important ingredient is that the banks are involved and defray the costs of crisis management. A stability fund financed with fees paid by banks has therefore been introduced. Besides the advantage of involving the institutions and ensuring that they pay for a financial crisis' costs, such a mechanism can facilitate the management of problems in institutions with multinational operations.

The principles for Government intervention in financial markets need further clarification. Clear, effective rules for the management of different types of financial crisis should be in place so that the financial system can remain functional and the costs for society can be limited. The Government has therefore appointed a committee to review the Swedish rules for the management of financial crisis in the light of, for example, the lessons that can be drawn from the development and management of the financial crisis that began in the autumn of 2008.[23] The committee is to report its findings not later than 15 August 2012.

7 Transparency and clarity

If fiscal policy is to be steered by the framework and be possible to monitor, its presentation needs to be transparent and comprehensive. Citizens must be able to gain an insight into every aspect of fiscal policy. The regulations and principles that govern the presentation of fiscal policy are described in the following.

7.1 The content of economic bills and other documents

Provisions concerning the Spring Fiscal Policy Bill, the Budget Bill, bills with amendments to the central government budget and the Government's Annual Report are included in the Instrument of Government, the Riksdag Act and the Budget Act.

7.1.1 The Spring Fiscal Policy Bill

Provisions for the content of the Spring Fiscal Policy Bill are included in the Riksdag Act and the Budget Act. Supplementary provision 3.2.2 of the Riksdag Act states that the Government shall submit a bill no later

[23] Dir. 2011:4.

than 15 April each year, setting out proposals for guidelines for future economic and budgetary policy. The Act's supplementary provision 5.12.1 states that decisions relating to the purposes and activities to be included in an expenditure area are to be taken in conjunction with decisions relating to the Spring Fiscal Policy Bill.

The guidelines for what should be contained in the Spring Fiscal Policy Bill are not specified in more detail in the Riksdag Act. In practice, however, the Bill includes the Government's assessment of the current economic situation, forecasts of economic developments in the coming 3–4 years, an account of the challenges that policy faces in the fields of structural, stabilisation and redistribution policy, compliance with budget policy's goals, estimates of effects of measures and an assessment of the current room for reforms or the need of consolidation measures. It is also the practice for the Spring Fiscal Policy Bill to include a separate account of redistribution policy and an assessment of the public finances' long-term sustainability. In addition, it should be possible to adapt the Bill's content to the current political and economic situation. Another practice is for the Bill to include the Government's assessment of the economic situation in the local government sector. The drafting of tax proposals for the coming budget year is normally to start sufficiently early for their budgetary consequences to be taken into account in the Budget Bill. The Spring Bill's chapter on guidelines accordingly includes the direction of the Government's structural, stabilisation and redistribution policy as well as of its budget policy for the coming years.

Provisions in the Budget Act require the Government to present forecasts in the Spring Bill for State revenues and expenditures, the borrowing requirement and expenditures under the expenditure ceiling. The forecasts are to be for the current budget year and the next three years and be based on clearly specified preconditions (Ch. 9, Art. 3). The Government shall explain considerable discrepancies between budgeted amounts and estimated outcomes for the current budget year (Ch. 9, Art. 1). It is also the practice that the Government's Spring Fiscal Policy Bill includes a preliminary assessment of an appropriate expenditure ceiling for the third year ahead; this normally serves as the basis for the proposed expenditure ceiling in the subsequent Budget Bill (see also section 7.1.2.).

7.1.2 The Budget Bill

The basic provisions for the Budget Bill are included in the Instrument of Government. They stipulate that the Government is to present a budget bill to the Riksdag (Ch. 9, Art. 2), that the Riksdag adopts the budget for the coming budget year, and that its decisions shall include an estimate of State revenues and appropriations for specified purposes. The Riksdag may decide that revenues may be used for specified purposes in other ways than decisions about appropriations (Ch. 9, Art. 3). The Riksdag may also decide guidelines for central government activities for a period other than the coming budget period (Ch. 9, Art. 6). Examples of such decisions on guidelines are those on the expenditure ceiling and on the surplus target.

Further provisions concerning the content of the Budget Bill are included in Chapter 3 Article 2 of the Riksdag Act. They stipulate that the budget year begins on 1 January and that prior to that the Government shall submit a bill (the Budget Bill) setting out proposals for State revenues and expenditures for the budget year. The Budget Bill shall include a budget statement and a budget proposal. If the Riksdag has decided, in keeping with practice, to allocate spending to expenditure areas, the budget proposal shall include an allocation of appropriations according to those areas. Moreover, a bill relating to State revenue, or expenditure for the coming budget year, may be submitted subsequently to the Budget Bill only if the Government considers that exceptional economic policy grounds, e.g., a crisis package, exist for such action. Thus, the Budget Bill shall be complete when it is submitted and other bills with separate budget proposals may normally not be submitted in the period up to the beginning of the new budget year.

Supplementary provision 3.2.1 to the Riksdag Act states that the Budget Bill shall be submitted no later than 20 September in years in which there is no election to the Riksdag in September. In other cases, the Budget Bill shall be submitted no later than one week after the opening of the Riksdag session. If this is impossible due to a change of Government, the Budget Bill shall be submitted within ten days of the date on which a new Government takes office, but no later than 15 November.

In practice the Budget Bill largely adheres to the disposition of the Spring Fiscal Policy Bill, except that the policy guidelines in the latter are converted into specified proposals, above all for the coming budget year, which are presented in the Budget Statement. Moreover, in contrast to the Spring Bill, the Budget Bill normally does not include a lengthy account of redistribution policy or a statement on the public finances' long-term sustainability, though it does usually contain a briefer updating of the more detailed accounts in the same year's Spring Bill. In addition, an account of economic equality is presented annually.

The content of the Budget Bill is also regulated in several respects in the Budget Act. Thus, the Government is required to include a proposed ceiling for central government spending (the expenditure ceiling), to be used in the drafting of the budget and in the execution of the budgeted activities. The proposal is to refer to the third future budget year (Ch. 2, Art. 2). If the Riksdag has decided to allocate central government spending to expenditure areas, in the Budget Bill, the Government shall present estimates of spending's distribution by expenditure areas in the second and third future budget years (Ch. 2, Art. 3). The Budget Bill shall also include forecasts of central government revenues and expenditures, the borrowing requirement and expenditures under the expenditure ceiling. The forecasts are to be for the current budget year and the next three years and be based on clearly specified preconditions (Ch. 9, Art. 3). The Government is required to explain considerable discrepancies between budgeted amounts and estimated outcomes for the current budget year (Ch. 9, Art. 1). Moreover, the Budget Bill shall include an account of the results that have been achieved in the Government's activities in relation to the goals laid down by the Riksdag (Ch. 10, Art. 3).

The Budget Act also contains detailed provisions for the scope of the budget as well as its revenue headings and appropriations (Ch. 3 & 4). Other provisions concern economic commitments and lending (Ch. 6), financing of investment and lending (Ch. 7) and acquisition and transfer of property (Ch. 8). As a rule, proposals in these areas are submitted in the Budget Bill or in bills with budgetary amendments (see section 7.1.3).

7.1.3 Budgetary amendments

In the course of a budget period, the Riksdag may revise its estimates of revenue, alter appropriations already made and make new appropriations (Instr. of Govt., Ch.9, Art. 4). The Riksdag has declared that proposed budgetary amendments are to be submitted in connection with the Spring Fiscal Policy Bill and the Budget Bill. Proposals to amend the budget may also be submitted on other occasions in exceptional circumstances (bet. 1993/94:KU18), for instance in an economic crisis.

Proposals to amend the budget should be submitted in the event of extensive or permanent and unforeseen increases in expenditures, as well as temporary unforeseen increases due to a faulty or altered base for the estimated appropriation. The procedure for budgetary amendments shall be as stringent as that for the Budget Bill. Thus, the requirements for financing, for example, are normally to be equally strict. Proposed increases in expenditure should be financed in the first place by cutting other spending. At the same time, substantial and unforeseen increases in expenditure in various activities can occur for which financing cannot always be required, provided there is room below the expenditure ceiling and the increase is compatible with the surplus target. Budgetary amendments should be proposed in the first place in cases in which the requisite funds cannot be obtained from existing appropriations, including saved appropriations. In cases where the Government chooses to propose budgetary amendments even though resources are available, the Government should explain why existing appropriations cannot be utilised.

7.1.4 The Government's Annual Report

An Annual Report to the Riksdag has to be submitted by the Government after the end of the budget period (Inst. of Govt., Ch. 9, Art. 10). The Budget Act stipulates that the Report is to be submitted no later than 15 April in the year after the budget year (Ch. 10, Art. 5). The Budget Act also contains detailed provisions for the content and scope of the Annual Report, basic accounting rules and forms for the presentation of the profit and loss account, the balance sheet and the financial analysis (Ch. 10, Art. 6–10).

The content of the Annual Report is to be such that it agrees with the Riksdag's decision on the Government's budget. It shall include an account of the various revenue headings and appropriations compared with the budgeted amounts. The Annual Report shall also reflect other

economic decisions by the Riksdag, e.g., authorizations to order goods and services as well as decisions concerning contributions, remunerations and loans that entail expenditures in future years. The Annual Report shall also inform the Riksdag about expected losses and substantial risks in issued guarantees and loans (see also section 7.1.6). Compliance with the Riksdag's goals for budget policy is to be reported. The Annual Report shall also include the profit and loss account, the balance sheet and financial analysis, the development of central government debt, an overall account of measures the Government has taken in response to observations by the National Audit Office, and a presentation of the EU accounts.

7.1.5 Tax expenditure report

The Budget Act stipulates that tax expenditures[24] are to be reported annually by the Government to the Riksdag (Ch. 10, Art. 4). This is done in a separate report. The account of tax expenditures serves two purposes. One is to manifest the indirect support to households and firms that is carried on the revenue side of the budget and which can partly, or wholly, have the same function as support on the expenditure side. The other purpose is to indicate the tax rules' degree of uniformity as uniformity is considered to contribute to the tax system's effectiveness.

7.1.6 Risk analyses of State guarantees and credits

A risk analysis that gives a true picture of the State's credit and guarantee portfolio is important in several respects. If the risks are found to be great, the analysis provides an important basis for decision-makers who need to take measures to enhance resilience to shocks or reduce the risks. Indications that the risks are small is valuable for the State's creditors; they can feel secure about lending, which keeps borrowing costs down. The National Debt Office is therefore instructed to analyse the risks in the State's portfolio of guarantees and loans on a continuous basis. [25]

The risks are analysed from two perspectives. One is the State's credit risk, the aim being to indicate the losses which State guarantees and credits are liable to entail. The focus here is the size of the potential losses for State wealth, in the first place in the medium and long terms. The other perspective is the State's liquidity risks, that is, the size of the payments that could be necessary in highly negative scenarios. The perspective here is short-term, and the analyses assume that the payments would entail corresponding increases in the borrowing requirement. If very large payments were required in the short run, there would be a risk of higher borrowing costs, particularly if guarantees had to be honoured

[24] Public support for firms and households is booked on the whole as spending on the expenditure side of the budget but there is also support or spending that is provided via the tax system; such support is called tax expenditures.
[25] As of 2012, material for the overall analysis of risks will be submitted annually by the National Debt Office to the Ministry of Finance. The Government's account in its Annual Report will be based on this material.

at a time when the borrowing requirement is already high for other reasons. The results of these analyses are reported annually and the methods are developed continuously.

7.2 Estimates of effects, forecasts and access to top-quality data

Forecasts and estimates of the effects of fiscal measures need to be obtained with the best available methods. The methods and models for these purposes are to be rooted wherever possible in the current state of research. As far as possible, the Government presents computing conventions that indicate how forecasts and effect estimates are obtained.[26] The Government's communication of the relevant models and methods is important for enhancing confidence in the ensuing assessments.

Forecasts are inherently uncertain. In addition to a main scenario, the Government therefore presents a number of alternative scenarios to illustrate downside and upside risks in economic developments. The forecasts also need to be monitored. The Government has therefore instructed the National Institute of Economic Research annually to produce comparisons of different forecasters' predictions and their accuracy; the comparisons are to include the Government's forecasts.[27]

The published forecasts incorporate the proposals that are included in the bill in question. Forecasts are presented for at least three years ahead. A Government assessment of economic developments in Sweden and the public finances is normally presented in connection with the Spring Fiscal Policy Bill and the Budget Bill. If economic developments so require, in the meantime, the Government also presents its economic assessment compared with the picture in the most recent bill.

Estimates of effects are produced in connection with proposals for new reforms that can be expected to have substantial macroeconomic consequences. Wherever possible, all proposals are analysed for effects on the public finances, GDP, employment and income distribution.

The Government is responsible for the availability of relevant data on the national economy. This is a prerequisite for the quality of forecasts, estimates of effects and other material for decisions. The quality of statistics on the public finances is particularly important. This is essential for the credibility of Sweden's compliance with requirements in the Stability and Growth Pact. The quality of data produced by Statistics Sweden and other central government authorities is to be as high as possible.

[26] A project has started in the Ministry of Finance to provide greater insight into how the forecasts and effect estimates are produced. The aim is to present the results stepwise as they become available. The degree of detail in these computing conventions will vary from area to area.

[27] Regulation (2007:59) with instruction for the National Institute of Economic Research.

7.3 Fiscal policy's long-term sustainability

The Government's assessment of fiscal policy's long-term sustainability is presented annually. It is based on estimates that extend so far into the future that all reasonably foreseeable demographic and economic changes are taken into account. The calculations usually cover the development of all public revenues and expenditures in the current century. Estimates of this type shall also be done prior to major reforms that are likely to have decisive consequences for fiscal policy's long-term sustainability.

Long-term computations are needed so that measures whereby fiscal policy will be sustainable in the long term can be proposed and approved at an early stage by the Government and the Riksdag, respectively, even when the threat to sustainability lies in the distant futuere. The primary purpose of the estimates is to determine whether the current fiscal policy is sustainable in the long term in the sense that the revenue generated by the present tax rules is sufficient to finance public expenditures in the long run, taking into account the initial level of public sector net debt, the demographic outlook and other relevant trends. An affirmative outcome indicates compliance with the public sector's inter-temporal budget restriction (see section 2.1). This shows that today's tax system is capable of generating the tax revenues that are needed for future generations to be guaranteed the same standard of public welfare systems as today's generation.

In the EU, the long-term financial sustainability of fiscal policy is assessed with the S2 indicator, which is derived from the public sector's inter-temporal budget restriction.[28] This indicator denotes the magnitude of the permanent budget reinforcement, or weakening, that is required to make fiscal policy financially sustainable in the long term. An S2 indicator of 1 per cent of GDP, for example, implies that in order to balance revenues and expenditures in the long run, taxation must be increased or expenditures cut immediately and permanently by the equivalent of 1 per cent of GDP.

Estimates of this type are, however, extremely uncertain and must therefore be interpreted cautiously. Consequently, it is reasonable that small deviations from S2=0 are treated differently from large, besides analysing the uncertainty by studying the result's sensitivity to changes in the underlying assumptions. In order to illustrate the uncertainty in the calculations, instead of a single estimate the Government uses a number of scenarios based on alternative assumptions to demonstrate how negative as well as positive risks affect the public finances' sustainability. These scenarios are then used to make an overall assessment of the public finances' long-term sustainability. In view of the estimates' uncertainty, minor deviations from S2=0 should normally not occasion any abrupt realignment of fiscal policy. Sizeable deviations, on the other hand, indicate that the problem is more serious and calls for a deeper analysis. The assessments are further qualified by analysing the

[28] The S2-indicator is described in more detail in the departmental memorandum (Ds 2010:4), annex 1.

cause of S2's level and the temporal distribution of primary surpluses and deficits. If, say, a reinforcement is needed on account of large deficits in the distant future despite a good financial development in the coming decades, the assessment of fiscal policy's sustainability and requisite measures should differ from when the same reinforcement is needed for deficits that are expected to arise in the relatively near future.

Even if S2 does not exceed what can be regarded as financial sustainability, this does not necessarily mean that fiscal policy is sustainable in a broader sense (see also section 2.1). For example, a fiscal policy that is sustainable in terms of S2=0 can be perceived by the financial markets as unsustainable if cyclical factors are generating a rapid short-term increase in debt. In another example, S2=0 can hold if present generations incur large debts on the assumption that they will be financed by future generations. That, however, would imply generational inequality. A third example is that S2=0 can hold even though the public sector budget deficit exceeds the EU ceiling of 3 per cent of GDP. Conversely, a sizeable deviation from S2=0 is not always a sufficient reason for realigning fiscal policy in the short term. An example of this is if the deviation is occasioned by the assumption that demand for welfare will grow as real income rises over time; such an increase in demand should be financed by future generations, not today's (see also section 3.3.1).

A more comprehensive assessment of *fiscal policy's* sustainability, not just *financial sustainability*, requires that the value of S2 is discussed in a broader framework. It its analysis of fiscal policy's long-term sustainability the Government therefore uses other indicators besides S2. It is important, for example, to check that Maastricht debt does not exceed 60 per cent of GDP, as stipulated in the Stability and Growth Pact. Moreover, to safeguard generational equality, at regular intervals, the Government supplements the estimates of sustainability with generational analyses.[29] These indicate whether a systematic redistribution between different generations occurs via the public sector. In cases where reforms can be expected to have major consequences for the distribution of incomes between generations, generational analyses are to be included when the proposal is drafted.

Another important foundation on which to base a sustainable fiscal policy for the long run is the Long-term Survey, which is undertaken roughly every third or fourth year (see e.g. SOU 2011:11). Challenges and possibilities for the Swedish economy in the long term are analysed, together with their consequences for the construction of economic policy. Unlike the case with other government inquiries, the Government does not issue any terms of reference for the Long-term Survey. Instead, it is the Survey, which chooses the subjects and methods that it considers most suitable for the purpose of providing a foundation for policy and for contributing to the debate on economic policy. When the Survey has

[29] The most recent generational analysis was done in 2006 (Pettersson, T., T. Pettersson & A. Westerberg (2006), Generationsanalyser – omfördelning mellan generationer i en växande välfärdsstat, ESS 2006:6). Work on developing models is in progress in the Ministry of Finance with a view to constructing a new model that can be used for such analyses.

been circulated for comments, the Government presents its opinion in the Spring Fiscal Policy Bill or the Budget Bill.