

22 November 2013

The Swedish Fiscal Policy Council (SFPC) has been asked to respond to the following inquiry:

Inquiry into proposals for an independent fiscal body – the Finance Committee, Scottish Parliament, call for evidence

In evidence to the Finance Committee on 1 May 2013 the Cabinet Secretary for Finance, Employment and Sustainable Growth stated that as a consequence of the new financial powers arising from the Scotland Act 2012: “Scotland will require an independent forecasting body that can provide independent assessment to the Government and the Parliament of what might be generated as a consequence of those taxes.”

The Cabinet Secretary has stated that it is his intention to establish the new body prior to the implementation of the newly devolved taxes in April 2015.

Given this background, the Committee would welcome views on the proposed independent forecasting body including:

- **What should be the role and remit of the new body?**
- **Should the new body be established on a statutory basis?**
- **What powers should the new body have?**
- **Should such a body be appointed by and accountable to the Executive or the Parliament (or both)?**
- **What would be the key objectives for the new body; what should be its key reports/areas of analysis?**
- **In the light of the OECD’s suggested principles for independent fiscal institutions what should be the core principles for the new body?**

The response of the SFPC follows below.

Introduction

- Independent fiscal institutions in European countries are a highly diverse group. They come in all shapes and sizes. In some countries they are deeply involved in making budget estimates and calculating costs of reforms on behalf of the Government, whereas in others they make no estimates at all and stay at arm's length from the budget process. In some countries, the institutions have more than a hundred employees and in others only a handful. Some are formally organised under the government and others under the parliament. Some form part of the national audit institutions and others are stand-alone bodies. Some have been established since long and others are currently being set up in response to the requirements of the new fiscal framework at EU-level. This diversity probably reflects political, administrative and cultural diversity.
- I will try to answer the Committees questions from a Swedish perspective and describe how the SFPC is set up and why. You will notice that, to a large extent, I will refrain from giving advice on how the forthcoming Scottish independent forecasting body should be designed. The reason for this is as follows: the impact of an independent body depends on the economic policy culture and traditions of governance. A country which has a culture where the public holds a strong trust in public institutions, in government effectiveness and honesty, in the accountability of elected politicians, in the democratic process and in the rule of law, probably has an environment which makes an independent body more effective. These prerequisites concerning governance are not always available. In addition, they are difficult to establish in the short run. Although an open society with strong public trust in the political system and in the role of experts makes it easier for an independent body to make an impact, we should not expect the opposite to hold: an independent body *per se* does not bring about immediate trust in public governance. However, an independent body may in the long run contribute to trust in the political system. Unfortunately, my knowledge of the situation in Scotland is only rudimentary and I will therefore abstain from giving specific advice on most of the topics that the

Committee investigates. However, I will try to frame my description of the SFPC in such a way that it can, hopefully, be of some use in the Committee's work.

Background

- The SFPC was established in 2007 and published its first report in the spring of 2008. The Council was neither set up in response to an acute crisis, nor due to demands from the stricter fiscal framework in the European Union. It should rather be seen as a step in a long ongoing process of strengthening the national fiscal procedures and institutions that began in the early 1990s. To make a long story short, the crisis in the 1990s included a banking crisis, a collapsed currency regime, budget deficits of more than 12 per cent of GDP, and a sharp rise in government debt. This was a dramatic time which changed the mind-set of decision-makers and formed the starting point for reforms of important fiscal institutions.
- The SFPC was set up as a complimentary institution to other, previously well established bodies. There is the National Institute of Economic Research (NIER), a government financed agency that regularly produces and publishes independent macroeconomic as well as fiscal forecasts. There is also the Swedish National Financial Management Authority that, among other tasks, also publishes budgetary forecasts that are independently estimated.

The SFPC response to the Committees questions

Q1: What should be the role and remit of the new body?

- The role of the SFPC is not to make economic forecasts or budget estimates, but instead primarily to assess and make independent judgments about how well the government maintains and adheres to the fiscal framework, with emphasis on the two core fiscal rules, a surplus target for the public sector and an expenditure ceiling for the central government. The remit, however, is broader. The SFPC should also assess government policies from a cyclical perspective, as well as long term fiscal sustainability. Distributional effects and effects on employment of government policies should also be assessed. The SFPC may also assess the quality of economic or fiscal forecasts and the underlying models. In addition, the Council should contribute to the public debate with regard to economic policy issues.
- The SFPC is obliged to publish an annual report but is free to publish further reports at will.
- The mandate of the SFPC is laid down in a government instruction. The instruction is not a statutory law. In practice, however, there were discussions between all parties in parliament which resulted in a broad agreement about the content of the mandate, even though the instruction was not manifested as a law in itself.
- The Council consists of six members, on non-renewable three year appointments. The composition of the Council should, according to the Government's instruction, encompass both high academic expertise and practical policy making experience. Currently the SFPC has four academic professors, one of whom is Norwegian; one former member of the Central Bank's governing board and one former Auditor General and Budget Director. Council members are given a modest remuneration and are expected to spend about 10-15 per cent of their working time for the Council. The Council is supported by a secretariat of five full-time employees.

Q3: What powers should the new body have?

- The SFPC has no formal power. It does not endorse the budget documents and it does not produce or endorse any economic or budgetary forecasts. The Council does not have the power to force the government to take certain actions. As a non-euro country, Sweden is not obliged to have an independent fiscal institution to ensure that the national budget is in compliance with EU-rules.
- The national fiscal framework does not include any formal sanctions against a Government that breaches the fiscal rules. The only sanction is reputational and ultimately depends on the confidence of the electorate and the financial markets. Thus, the Council is not involved in triggering any sanctions or activating any correction mechanisms.
- The Council's annual report is to be published no later than May 15, according to the agency's instructions. The budget bill is presented in September, and the parliamentary budget process takes place between September and December. The Council's annual report is mainly focused on *ex post* analysis (but you can find traces of *ex ante* analysis in our reports). The Council's potential influence on the Government's policies work over longer time periods than the annual process. The power of the SFPC comes solely from its ability to deliver high quality analyses that make an impact in the public and political economic debate. Therefore, the quality of the reports and their impact on public debate are of crucial importance. The Council is also consciously trying to keep its reports non-technical and thus accessible for a broad audience.

Q4: Should such a body be appointed by and accountable to the Executive or the Parliament (or both)?

- From an organizational perspective, the secretariat of the SFPC is set up as government agency. The Council itself, with its six members, can be seen as a working group at the agency. This construction is intended to separate the role of the Council members and their potential criticism of the Government, from the role of heading the agency, including having annual budget discussions with the Government.
- When the SFPC was introduced there was a discussion about by whom the agency should be financed and to whom it should be held accountable. It can of course be questioned whether a government-financed agency can fill the role of an independent fiscal institution. There were, however, a number of arguments that this set-up was acceptable. First and foremost, Sweden has a long-standing tradition of considerable independence among government agencies. Secondly, members of the Council have great professional integrity and a, so to speak, reputation to lose if they were to be perceived as biased. Thirdly, being a council member is only a part-time occupation, and the members are not financially dependent on the Council, i.e. the opportunity cost of resigning from the SFPC is low. Fourthly, transparency is a key ingredient to safeguard the Council's independence, regardless of the financing model.
- Even though the SFPC is a government agency, the annual report is sent to the Parliament and it is customary to hold a public hearing where the Chairman of the Council discusses the report with the Minister of Finance and the Finance Committee.
- So far, the model chosen in Sweden has neither put restrictions on the Council's reports nor given rise to questions about the Council's independence. In another political setting or with other institutional traditions the question of accountability towards the executive or legislative could be of greater importance.

Q2: Should the new body be established on a statutory basis?

- That might be a good idea. But as I explained in my introduction: it all depends on the Scottish political and administrative tradition.

Q5: What would be the key objectives for the new body; what should be its key reports/areas of analysis?

- To provide accurate and authoritative revenue and expenditure projections.

Q6: In the light of the OECD's suggested principles for independent fiscal institutions what should be the core principles for the new body?

- The following two principles in OECD's document ("DRAFT PRINCIPLES FOR INDEPENDENT FISCAL INSTITUTIONS, Reykjavik, Iceland, 7-8 June 2012") appears to me to be of particular importance in the Scottish case:

Principle 1.1: To be effective and enduring, an IFI requires broad national ownership, commitment, and consensus across the political spectrum.

Principle 2.1: Non-partisanship and independence are pre-requisites for a successful IFI. A truly non-partisan body does not present its analysis from a political perspective, always strives to demonstrate objectivity and professional excellence, and serves all parties. This favors that IFIs should be precluded from any normative policy-making responsibilities.