

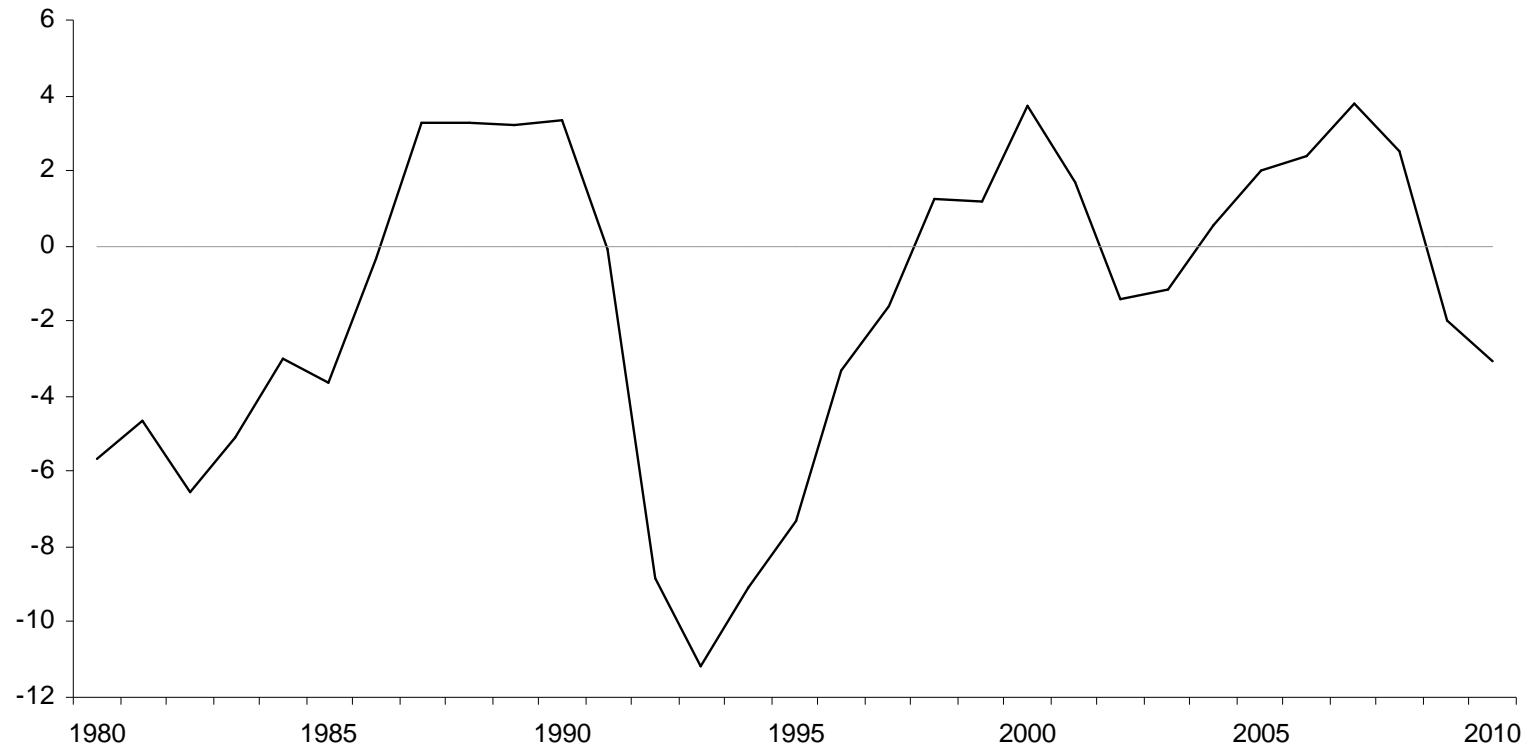
# The Swedish Fiscal Framework and the Fiscal Policy Council

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Workshop on Fiscal Rules and Institutions

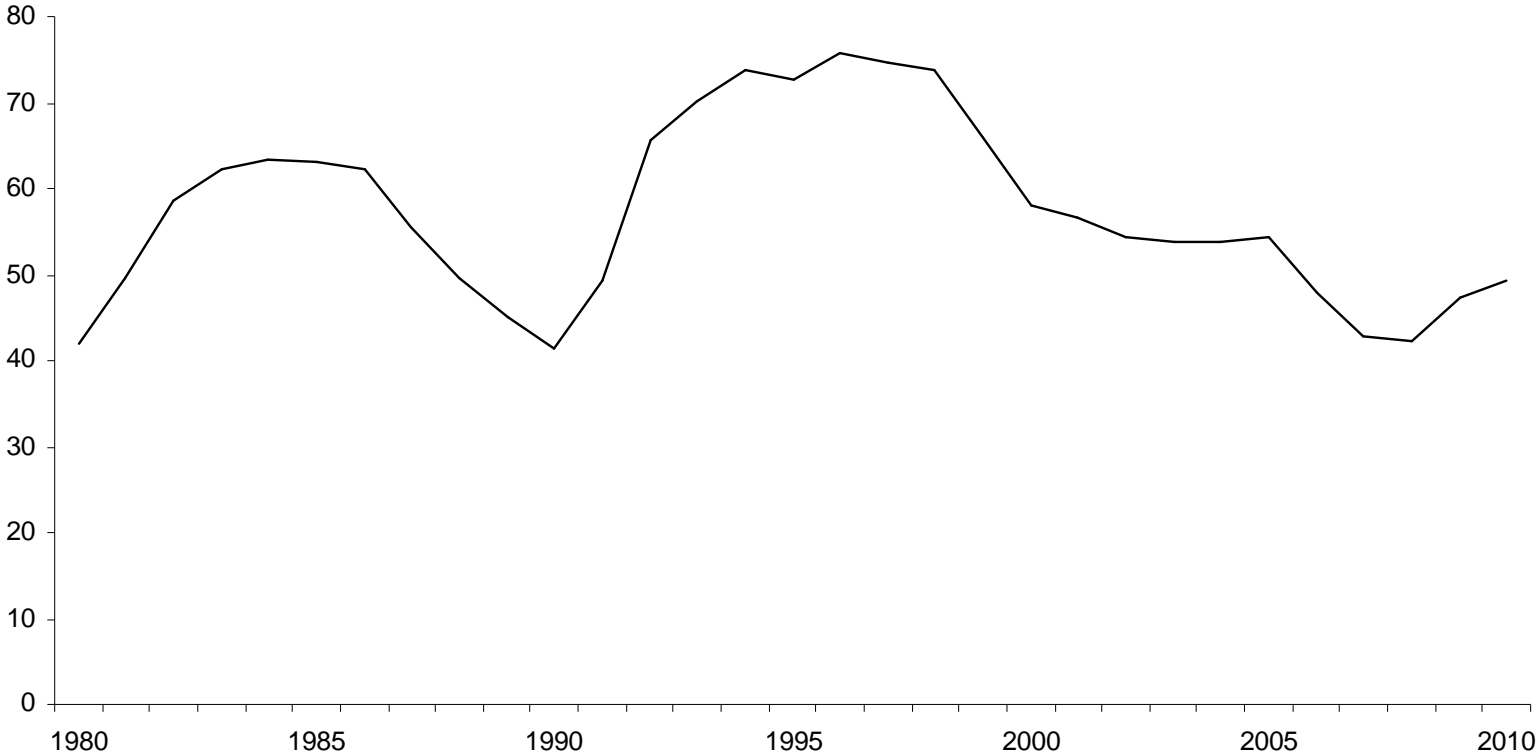
OECD, 22 March, 2010

## General government net lending in Sweden, per cent of GDP



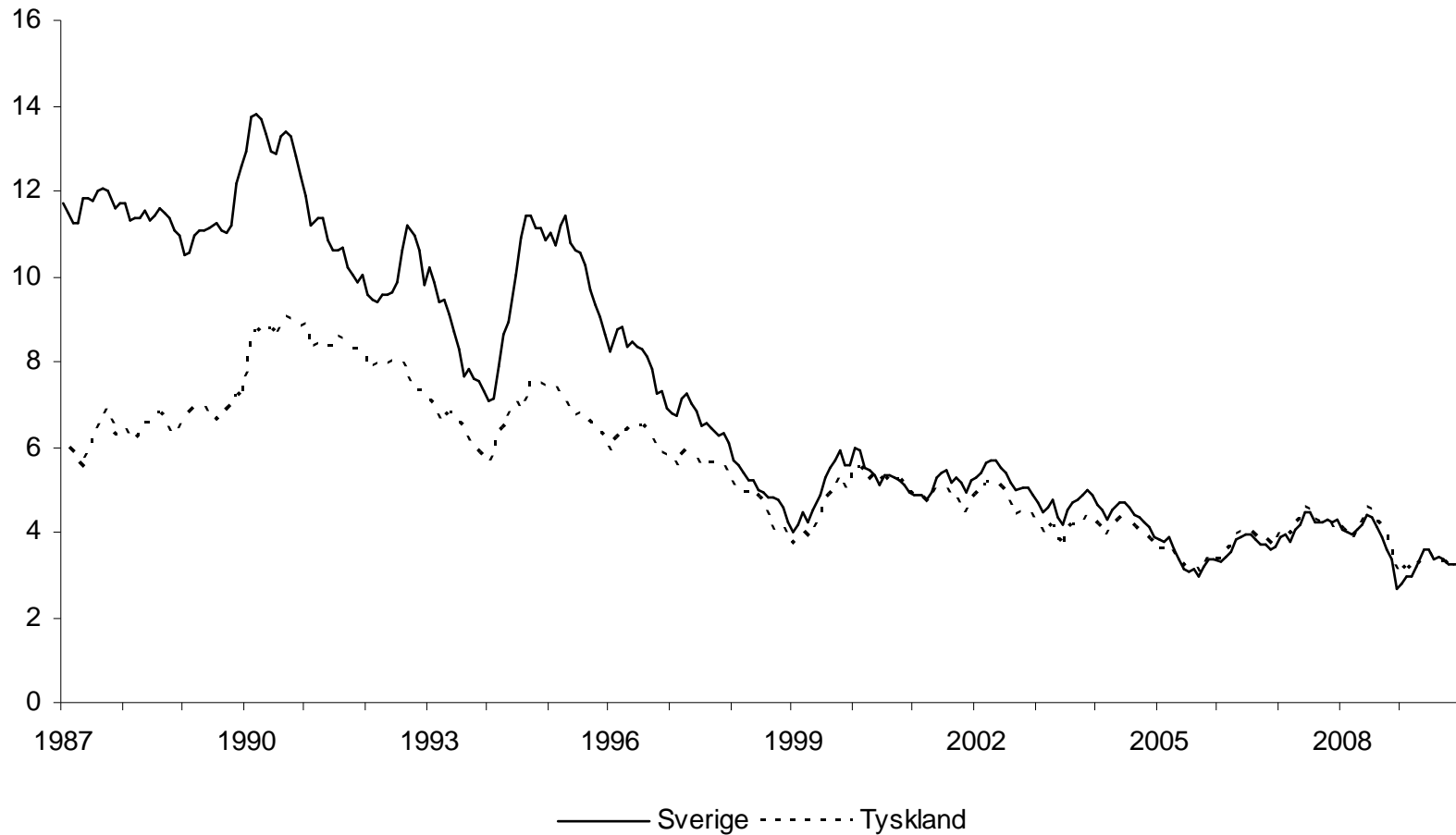
Source: OECD.

# General government gross debt in Sweden, per cent of GDP



Source: National Institute for Economic Research.

## Interest rates on ten-year government bonds in Sweden and Germany



Source: The Riksbank.

## The S2-indicator on fiscal sustainability

Belgium	5.3
Denmark	-0.2
Estonia	1.0
France	5.6
Germany	4.2
Greece	14.1
Ireland	15.0
Italy	1.4
Latvia	9.9
Lithuania	7.1
Netherlands	6.9
Spain	11.8
<b>Sweden</b>	<b>1.8</b>
United Kingdom	12.4
<b>Euro area</b>	<b>5.8</b>
<b>EU27</b>	<b>6.5</b>

# The Swedish fiscal framework

- Top-down approach for the central government budget
- Surplus target for government net lending
- Central government expenditure ceiling
- Balanced budget requirement for local governments
- Fiscal Policy Council

# What has worked and what has not worked in the Swedish framework?

- Obviously a strong fiscal situation
- But there are also potential problem
  - budget tricks with the expenditure ceiling: tax expenditures and timing of payments
  - insufficient motivations for the choice of numerical target
  - the exact meaning of the surplus target

# Fundamental objectives behind the intermediate surplus target

- Demography and sustainability
- Intergenerational fairness
- Social efficiency and tax smoothing
- Precautionary buffers
  - long-run developments
  - cyclical considerations



# A surplus of one percent of GDP over the business cycle

- Is it a backward-looking target with memory?
  - compensation for past deviations
- Is it a forward-looking target without memory
  - no compensation for past deviations

# Different indicators of the surplus target

Budget Bill for 2010, per cent of GDP

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	2008	2009	2010	2011	2012
<b>Actual fiscal balance</b>	<b>2,5</b>	<b>-2,2</b>	<b>-3,4</b>	<b>-2,1</b>	<b>-1,1</b>
<b>Historical average</b>	<b>1,6</b>	<b>1,2</b>	<b>0,8</b>	<b>0,5</b>	<b>0,4</b>
<b>Moving average</b>	<b>0,3</b>	<b>-0,1</b>			
<b>Cyclically adjusted balance</b>	<b>2,3</b>	<b>1,4</b>	<b>0,2</b>	<b>0,7</b>	<b>0,6</b>
<b>Historical average of cyclically adjusted balance</b>	<b>1,2</b>	<b>1,2</b>	<b>1,1</b>	<b>1,1</b>	<b>1,0</b>
<b>Moving average of cyclically adjusted balance</b>	<b>1,2</b>	<b>1,2</b>			

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# Need for amendments?

- Legal requirement on a surplus (fiscal) target
- Requirement that the government should explain how it will act when there are deviations of a certain magnitude according to pre-specified indicators
  - letter to the parliament
- Regular reviews of the target
  - co-ordination with pension rules
- Stricter rules prohibiting circumventions of the expenditure ceiling
  - instead well-defined *escape clause*
- Automatic cyclical adjustments in central government grants to local governments

# The Swedish Fiscal Policy Council

- Established in 2007
- Agency under the Government
- Independent evaluation of fiscal and other economic policy
- Annual report to the Government
- Public hearing in the Parliament
- Eight members
  - six academic researchers
  - two ex-politicians
- Small secretariat

# Background

- International discussion of Fiscal Policy Councils/Committees
  - advisory group giving recommendations
  - government obliged to base budget bill on forecasts of independent council
  - delegation of actual decision-making
- Proposal on Fiscal Policy Council by Government Commission on the EMU in 2002
- The earlier Social Democratic government did not like the idea
- Council established by liberal-conservative government in 2007 (Minister for Finance: Anders Borg)
- The Left Party: *“another body providing false scientific clothing for the government’s right-wing policy”*

# The council's remit

1. To assess if fiscal policy objectives are met
  - long-run sustainability
  - surplus target
  - expenditure ceiling
  - cyclical situation
2. To evaluate long-run employment and growth developments
3. To examine the clarity of the budget bills
  - grounds and motivations for policies
4. To evaluate the government's forecasts and the underlying models

The council "should work to achieve an increased public discussion in society of economic policy"

# A broad remit

- Trade-off between breadth and depth
- Risk that fiscal policy watchdog role is weakened
- But important "supervisory" role of economic policy discussion
- Prime objective: the fundamentally democratic one of raising the standards of the economic policy debate
- Why this remit?
  - other pre-existing bodies
  - "institutionalise" strong Swedish tradition of high-profile academic participation in economic policy debate

# Themes in the reports

- Increase the clarity of the surplus target: net lending of one percent of GDP over a business cycle
  - underlying fundamental objectives
  - too many indicators
- Criticism of circumventions of expenditure ceiling
- Critical evaluation of fiscal sustainability calculations
- More discretionary fiscal stimulus in the current recession (but less of permanent measures)
- Evaluation of the government's labour market reforms
- The economic reporting of the government



# The council's impact

- Extensive media coverage
- Formal response in the spring fiscal policy bill
- Impact on actual policy
  - what is the counterfactual?
  - fiscal stimulus in 2010
  - less effect on "budget tricks"
  - some effect on surplus target
  - some effect on economic reporting

# The council's role in the fiscal policy debate

- On average a fiscal policy council should be expected to advocate more fiscal discipline than the government
- But this need not always be the case: credibility gain
- The council must make its own judgements
- Stronger fiscal framework allows more discretionary stimulus in recessions
- The government's focus on fiscal discipline and the existence of the council are explained by the same factors



# The council and the standing of the finance ministry

- Unclear effect on the standing of the finance minister vs spending ministers
  - finance minister could be backed up
  - but other ministers get access to alternative analyses
- Effect within the finance ministry
  - technocrats are strengthened relative to politicians

# The council in the general political debate

- Political bias against the government
  - evaluations of government policy but not of opposition proposals
  - smaller problem in the long run
- Members are free to express their own views in the economic policy debate

# The council's independence

- Members appointed by the government: three-year renewable periods of office
- Risks balanced by:
  - appointments after council proposals
  - low pay
- Budget has to be negotiated with the government
- Main guarantee of independence: academic economists have their main activities in another arena
- But potential problem that everyone knows everyone in a small country

# The council's survival

- Too much power to independent academics?
- Initial reaction of the opposition: "experts should not evaluate the elected representatives of the people"
- Less clear today