Fiscal rules and the budgetary framework in Sweden

Dr Mårten Blix
Director in Budget Department
MoF, Sweden
Outline of talk

• Fiscal rules – medium term framework
• Key features of how the budget department works
• Recent improvements in framework
  – Evaluation and transparency
Experience of national fiscal frameworks

• Keep your own house in order – prevents need for stern consolidation later on
• Consolidation tends to be more successful and long lasting with expenditure cuts
• Countries with rules, especially expenditure targets, tend to achieve better consolidation results
• Fiscal rules need muscle behind them
Two fiscal rules in Sweden

Expenditure ceiling $t+3$

The surplus target
1% of GDP over an economic cycle
Expenditure ceiling for central government (1)

- A few beauty spots but has never been exceeded
- Fixed 3 years in advance in nominal terms
- Main strength is that it is simple
- Includes all primary expenditure in the annual budget and the pension system outside the central government budget, but excludes expenditure of local governments
Expenditure ceiling for central government (2)

• Current government decides ceiling for t+3 on the basis of:
  – The level should be in line with long term sustainable public finances and the surplus target
  – The level as GDP-ratio shall fall slightly
  – The budget margin should be large enough on a 3-year horizon to cover uncertainties and forecast errors, currently estimated 3% of ceiling
Expenditure ceiling for central government (3) - motivation

- Implicit anchor for revenues needed to maintain sustainable public finances
- Mitigates common-pool problems
- Limits time inconsistency
- Reduces temptation to create permanent expenditure from temporary revenue boosts
- Transparency
Expenditure ceiling for central government (4) - results

• Expenditure ceiling forces priorities between different spending areas;

• Trade-off between rules and discretion
  – Freedom to let automatic stabilisers work
  – Freedom to use discretionary fiscal policy: the medium term target need not imply pro-cyclicality

• Continuous evaluation
  – internal, external by national audit authority, fiscal policy council.
Surplus target

- General government net lending 1% of GDP over the business cycle.
- Gives medium term perspective and avoids pro-cyclicality
- Pre-funding of the budgetary impact of ageing populations
# Key fiscal figures at a glance

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
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</thead>
<tbody>
<tr>
<td><strong>Net lending</strong></td>
<td>2,5</td>
<td>-2,2</td>
<td>-3,4</td>
<td>-2,1</td>
<td>-1,1</td>
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<tr>
<td>Average since 2000</td>
<td>1,6</td>
<td>1,2</td>
<td>0,8</td>
<td>0,5</td>
<td>0,4</td>
</tr>
<tr>
<td><strong>Structural balance</strong></td>
<td>2,3</td>
<td>1,4</td>
<td>0,2</td>
<td>0,7</td>
<td>0,6</td>
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<tr>
<td><strong>GDP-gap</strong></td>
<td>0</td>
<td>-6,4</td>
<td>-6,5</td>
<td>-5,0</td>
<td>-3,0</td>
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</tr>
<tr>
<td><strong>General gov revenue ratio</strong></td>
<td>52,7</td>
<td>51,9</td>
<td>51,7</td>
<td>51,6</td>
<td>51,3</td>
</tr>
<tr>
<td><strong>General gov exp ratio</strong></td>
<td>50,2</td>
<td>54,1</td>
<td>55,1</td>
<td>53,6</td>
<td>52,4</td>
</tr>
<tr>
<td><strong>Public debt, consolidated</strong></td>
<td>38,0</td>
<td>42,8</td>
<td>45,5</td>
<td>45,6</td>
<td>45,2</td>
</tr>
</tbody>
</table>

Current projections for 2009 and 2010 much stronger
Objectives of the Budget

- Budget discipline
- Overall economic efficiency
- High quality and efficiency in the administration

Strong role of MoF and Budget department – all expenditures have to be assessed by budget department
Fiscal discipline and economic efficiency

NO!
Notable features of how we work

• Strong delegation to staff and line managers
• Contact persons represent the Budget department’s formalised connection with the line ministries
• Frequent ‘informal’ contacts between minister and staff
• Benefits of system: learning process for all
Improvements in fiscal framework

- Clearer motives for the surplus target and indicators for evaluation
- Expenditure ceilings – three year perspective introduced
- More transparency for the ceiling
- Outside evaluation
- Fiscal Policy Council (strong mandate)
- National Audit Office (independent)
Swedish finances have strengthened substantially

- Deficits replaced by surpluses
- General government debt as percent of GDP has fallen from 73 per cent of GDP in 1996 to less than 40 per cent in 2008
- In better position to face the present crises compared to many EU countries
- Expenditure ceiling will be a key instrument in our efforts for a fiscal exit and beyond
Conclusions (1)

- Fiscal rules should be simple, measurable and enforceable
- They need to be protected
- Informal aspects can sometimes be as important as formal rules
- Rules also handle long term commitments ageing population
Conclusions (2) expenditure ceiling needs institutional support

- Strong role of MoF
- Budget Dep as watchdog
- Top-down budget
- Complete budget
- Rules in parliament
- Outside monitoring
- Political will
Very expansionary fiscal policy
2009-10
Source: OECD Economic Outlook 2009, June
Public debt in Sweden compared to EU

- Gross Public Debt. Source: OECD.
Government revenues in Sweden - forecast revisions since Spring Bill 2008,
GDP in Sweden
Percentage change per year, 1920–2012

Note: Time series before and after 1950 are not completely comparable. The quality of data from earlier years is more uncertain. Sources: Edvinsson (1920–1949) and Statistics Sweden (1950–2008); forecast from Ministry of Finance (2009–2012).
GDP growth and forecast

Sustainable public finances in Sweden

The S2 indicator shows the permanent improvement in surplus needed for sustainable public finances. A negative number implies that the public finances are sustainable and can withstand some weakening.

Source: European Commission 2009.