

The Medium-term Fiscal Framework in Sweden

by
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Since 1997, a medium-term fiscal framework has been applied to virtually all aspects of budget preparation in Sweden. The longer three-year horizon has enabled better fiscal discipline through the use of fiscal targets and advanced forecasting models. Particular attention is placed on ensuring the consistency and quality of forecasts. In addition, forecasting of revenues and expenditures is an exercise that involves all levels of the central government administration five or six times a year. Thus the preconditions for well-informed and rational decisions on government policies have been drastically enhanced in Sweden.

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1. Introduction

A key characteristic of budget preparation in Sweden is that virtually all information concerning macroeconomic and fiscal development is prepared and presented in a three-year perspective. By assuming such a medium-term framework, the preconditions for well-informed and rational decisions on government policies have been drastically enhanced compared to the previous order. A consistent presentation of revenue and expenditure, founded on a credible macroeconomic framework, for a period beyond the upcoming fiscal year, allows the government and Parliament to take into account events outside the annual cycle. The medium-term framework facilitates the formulation of appropriate policies at the same time as unwanted fiscal development can be avoided.

A medium-term framework has to be taken seriously. A medium-term framework is however only meaningful if taken seriously, and if projections are realistic and reliable. Experience from Sweden shows that formal requirements for the presentation of medium-term estimates can be a complement to, but in no way a substitute for, an actual demand for meaningful forecasts from decision-making bodies. Government and Parliament have to be committed to medium-term objectives. In Sweden, such an interest evolved with the introduction of medium-term fiscal targets for central government expenditure and general government surplus.

Credible forecasts are necessary. A central part of budget preparation and in-year monitoring revolves around forecasting. An updated macroeconomic framework is necessary to formulate appropriate policies, and to ensure realistic and reliable forecasts for revenue and expenditure. The Ministry of Finance produces a revised forecast of all relevant macroeconomic variables on four or five occasions a year. In addition, the government administration has to make continuous assessments of the development of each appropriation and revenue item in the budget. A complete forecast of all government expenditure in a medium-term perspective is made five or six times a year. The frequent and ambitious expenditure forecasting requires the support of a computerised system. Consequently, an integrated budget management system, in which the budget, forecast and outcome for each appropriation are presented, has been introduced in the Swedish government administration. The budget management system is accessible to all government agencies, line ministries and, naturally, to the Ministry of Finance.

A medium-term framework is not synonymous to multi-year budgets.

In this context it is necessary to point out that the Swedish budget is annual, corresponding to the calendar year. The medium-term fiscal framework is an instrument to strengthen the **quality** of annual budgets; it is not an attempt to replace them with multi-annual budgets. The government proposes, and Parliament approves, appropriations for one fiscal year, together with an extensive description of the purpose of each appropriation and an indication of the expected results. Alongside each appropriation, however, the budget also contains information on the estimated development for the two years beyond the upcoming fiscal year. In this sense, the medium-term approach applies to both financial and performance aspects of budget preparation.

2. Historical perspective

Prior to the budget reform in Sweden in the mid-1990s, budget preparation was exclusively focused on the upcoming fiscal year. Based on a macroeconomic framework for the current and the forthcoming year provided by the Economic Affairs Department, line ministries and the Budget Department calculated revenue and expenditure estimates for the budget. Neither for internal purposes nor for presentation to Parliament was there any indication of the development of government finances for the period beyond the year for which the budget was proposed.

As a consequence of the heavy focus on merely the upcoming year in the budget process, limited attention was given to macroeconomic development in the medium term. Somewhat simplified, the macroeconomic framework was produced by extrapolating relevant parameters such as GDP growth, household consumption, unemployment, and inflation. There was virtually no assessment of potential GDP or natural unemployment levels that could serve as an anchor for forecasting, and as a judgement of the cyclical position and of the appropriate fiscal policy.

Once a year, a so-called **long-term budget** was presented to Parliament. In this document budgetary projections for a five-year period were made, naturally based on a macroeconomic framework for the same horizon. The status of the long-term budget was however not specified. Revenue and expenditure were calculated as a baseline assessment of current policies, and little attempt was made to produce figures that could serve as a basis for a discussion on the sustainability of government finances. The long-term budget was not used as an input into the preparation of the actual budget. In retrospect, the rationale for this document could be questioned.

The long-term budgets, with their five-year assumptions of relevant macroeconomic parameters and the baseline assessment of revenue and expenditure for the same time horizon, could probably formally be labelled a

medium-term budget framework. This highlights the importance of integrating the medium-term approach into the **actual** and **operative** budget preparation process. The production of macroeconomic or fiscal projections that are not regularly updated, and that do not have a natural connection to decision making in the preparation or approval of the budget, is a meaningless exercise.

3. Fiscal targets

In the mid-1990s the budget process was fundamentally reformed, with the introduction of a top-down process for budget preparation and approval based on a medium-term fiscal framework.¹ Explicit numerical targets for the development of central fiscal parameters in the medium term created a demand for high-quality forecasts.

3.1. The expenditure ceiling

Beginning with the budget for 1997, the budget process in Sweden is guided by a nominal **expenditure ceiling** that covers all expenditure in the central government budget (except interest payments on government debt) together with the expenditure for the old-age pension system outside the budget. Since the expenditure ceiling is set three years in advance, there is an obvious interest in having access to realistic and reliable expenditure forecasts, founded on a credible and consistent macroeconomic framework. On the one hand, the government and Parliament have to be informed of the macroeconomic and fiscal development in order to set an appropriate level for the expenditure ceiling for the added year in the new three-year budget cycle. On the other hand, it is necessary to closely monitor fiscal development for the years for which an expenditure ceiling has already been set.

The expenditure ceiling is a restriction for **actual** expenditure. Government agencies have a certain possibility to use **carry-over** funds, in terms of unused appropriations from previous years and a credit on future years' appropriations. This means that expenditure can exceed appropriated levels. Since the expenditure ceiling is a restriction on the *ex post* outcome, rather than the *ex ante* budgeted figure, the government has to closely monitor and anticipate expenditure development to ensure that the ceiling is not exceeded.

Expenditure forecasts are at the centre of the government's attention, and they have a direct effect on fiscal policy. For a number of years in the early 2000s, forecast expenditure exceeded ceilings, mainly due to an unfavourable development of entitlements such as unemployment benefits and health-related transfer payments. Consequently, the government was forced to act to reduce expenditure in order to avoid exceeding the expenditure ceiling. Since the ceilings apply not only to the current fiscal year, but also to the upcoming year and the second and third additional years, the government

was forced to take into account the medium-term development of expenditure to make sure that fiscal targets were met. Conversely, a positive macroeconomic development, with robust growth and lower than expected inflation, and diminishing health-related transfer payments for the period 2006 to 2008 have provided the government with room under the ceiling that can be used for new policy initiatives on the expenditure side of the budget.

3.2. The surplus target

In addition to the expenditure ceiling, the general government surplus has been targeted at 2% of GDP on average over the business cycle. The annual surplus can deviate for an individual year, provided that the average over the business cycle reaches 2% of GDP. The government is consequently interested in the development of not only central government revenue and expenditure, but also the fiscal development of other parts of the general government sector, namely the old-age pension system outside the budget and the local self-government sector. Since 1997 all budget documents contain three-year forecasts of macroeconomic parameters, central government revenue and appropriations, and the development of the general government finances.

3.3. Fiscal targets stimulated the development of a medium-term framework

The introduction of fiscal targets in Sweden in the second half of the 1990s constituted a turning point in the value that the administration placed on medium-term projections. It is interesting to note that the merits of having access to reliable information on macroeconomic and fiscal development were not in itself a sufficient condition to stimulate an improvement of medium-term projections. The development of a forecasting capacity, and a consistent medium-term approach to all matters regarding budget preparation, took place only when there was a visible necessity for such a development. It is also striking that the transition from the previous order with separate long-term budgets to an integrated medium-term approach virtually took place from one year to another. Furthermore, such a transition was both initiated and implemented by the administration itself.

4. What are the reasons for a medium-term framework?

As discussed in the previous section, the catalyst for adopting a medium-term budget framework in Sweden was the introduction of fiscal targets, in the shape of a three-year rolling expenditure ceiling for the central government and a surplus target for the general government sector. It is probably fair to point out, however, that medium-term projections of government finances in Sweden serve a wider purpose than simply as a tool to monitor the development of revenue and expenditure in relation to the fiscal targets.

4.1. Time lags

To a large extent, decisions on government finances are affected by time lags. Issues that require some kind of intervention have to be identified. Relevant public decision-making bodies have to propose and approve of measures, after which certain activities have to be implemented. In addition to this, a certain amount of time is usually required before the policy comes into full effect. Appropriate policies, therefore, require early information on the development of factors that may motivate government intervention. An obvious example is counter-cyclical fiscal policy in general, and unemployment programmes in particular. By receiving an early warning on the development of the unemployment level, the government is in a better position to implement timely and appropriate policy measures to diminish cyclical variations. The same argument can be made for expenditure in the form of entitlements, which are affected by the number of individuals that fulfil the criteria for receiving benefits. In order for the government to ensure fiscal sustainability in the event of an unfavourable development of transfer payments, it is of utmost importance that an early warning is received so that measures can be quickly initiated to reduce expenditure.

4.2. Delayed effects

The access to information on the development of revenue and expenditure in the medium term also allows the government to better assess the impact of current and proposed programmes. In many cases, the full fiscal impact is delayed, and the presentation of the effect on government finances for a number of years is necessary for an objective evaluation of the government's policy. By assuming a three-year horizon in the budget framework, delayed or deferred effects become visible. An obvious example is investment programmes, where the initial expenditure usually is only a fraction of the fiscal impact for future years. Another example is the effect of changes in the tax system or entitlement programmes. Such changes often have behavioural effects, and the full impact is usually felt only after a couple of years. Yet another case is a programme that is initiated mid-year, so that the expenditure for the first year is only half of the upcoming year's fiscal impact. These examples illustrate the risk of underestimating the effect of government programmes by only looking at the upcoming year.

4.3. A medium term can highlight the scope for reallocations

A medium-term perspective in budget preparation can also promote reallocations in the budget. In a one-year perspective, which was the previous time frame for budget preparation in Sweden, the majority of expenditure is fixed, and there is limited room to make any significant changes in the

composition of government finances. Revenue is decided by tax legislation, and transfer payments are regulated by legislation. To a large extent, the government has also committed expenditure through previously entered civil law contracts with suppliers. Significant and rapid changes in the wage bill are prevented by employment legislation.

In a longer perspective, however, just about every item in the budget is flexible, and the government has the possibility of redirecting expenditure or making increases or reductions in both revenue and expenditure. As a rule, such changes require an early announcement. By looking at the years beyond the upcoming fiscal year, the government is in a better position to make changes that will have an impact on the development of government finances. By indicating the development of appropriations in the medium term, it is furthermore possible for the administration to initiate the planning procedures necessary for redirecting its operations to adjust to a reduction of funds.

In Sweden, the introduction of a medium-term budget framework has increased the government's attention to years beyond the upcoming fiscal year. Budget negotiations have an added dimension in that policy changes are presented that come into effect outside the time frame given by the budget. Such a development may not be altogether positive, as there are added risks by introducing a medium-term time horizon in budget negotiations in that resources are tied up and the government's flexibility is reduced.

5. The Stability and Growth Pact

According to the Stability and Growth Pact, European Union member countries are required to ensure sustainable public finances. This translates into a requirement that general government finances should be close to balance or in surplus, and that the gross debt ratio to GDP should not exceed 60%. The deficit for an individual year should not exceed 3% of GDP. To achieve these objectives, member countries are obliged to present an assessment of their public finances, together with country specific medium-term objectives, in their Stability or Convergence Programmes.

In order to comply with the requirements of the Stability and Growth Pact, a medium-term approach to fiscal management is necessary. It would not be possible for the Swedish government to assume responsibility for the development of government finances without the macroeconomic and fiscal projections for the medium term. In addition, the information presented to the European Commission and the European Council in the Convergence Programme is based on the medium-term assessment contained in the Budget Bill. Consequently, Parliament has full information on the information that the government presents in its Convergence Programme. In this context, it should be pointed out that the reform of the Stability and Growth Pact in 2005 put

emphasis on the long-term development of public finances. For that purpose, national medium-term targets should be set according to the member states' debt position and projected potential output growth.

6. Macroeconomic forecasts

A cornerstone of the medium-term fiscal framework in Sweden is the macroeconomic forecasts co-ordinated by the Forecasting Division under the Economic Affairs Department. Through the macroeconomic framework, which provides a picture of such variables as GDP growth, unemployment and inflation, the government is able to make an assessment of how the economy deviates from its equilibrium position and, consequently, how fiscal policy should be shaped. Furthermore, the macroeconomic assumptions are fed into medium-term revenue and expenditure forecasts to present the government with a picture of overall fiscal development and the expected trend for individual items in the budget.

6.1. *The Ministry of Finance produces independent forecasts*

The introduction of a medium-term approach to budget preparation has highlighted the importance of macroeconomic forecasting. As mentioned in Section 2, the previous order, with a heavy focus on merely the upcoming fiscal year, did not encourage the development of any advanced forecasting models through which a consistent and reliable assessment of the economy could be produced. Macroeconomic forecasting was rudimentary, with a simple projection of observed levels of relevant parameters. There was virtually no qualified judgement of whether or not the forecast figures were in line with a consistent framework of the overall economy. In addition, appropriations for transfer payments were, at that time, **open-ended**, and increased expenditure for these items was simply absorbed through an automatic increase in appropriated funds. There was hence little incentive to produce macroeconomic projections that would enable realistic forecasts of transfer payments.

This situation stands in sharp contrast to the attitude to and the capacity for macroeconomic forecasting in the Ministry of Finance today. In the Economic Affairs Department, a Forecasting Division with approximately 20 specialists is responsible for producing independent forecasts of all variables necessary for fiscal policy decisions and budget preparation. In four or five forecasting rounds a year, this unit makes a complete assessment of GDP growth, broken down into consumption, investment and net export, and an evaluation of the output gap, unemployment and inflation for various sections of the economy. An important objective for the medium-term macroeconomic framework is to ensure consistency between the forecast for individual parameters and a model for potential GDP. The Forecasting Division

also produces forecasts for the development of the world economy, which has a significant impact on the macroeconomic development of Sweden.

The Ministry of Finance produces independent forecasts, and does not rely on estimates produced by other forecasting bodies. On the one hand, this means that the government is in complete charge of the assumptions underlying its fiscal policy and the revenue and expenditure projections presented in the budget. On the other hand, there is a risk of **political bias** in the forecasts, in the sense that the government may want to present an optimistic macroeconomic picture to improve its popularity. The Ministry of Finance, however, has a high level of professional integrity, and historical evaluations of different forecasting bodies show that the forecasting precision of the Ministry of Finance is as good as, if not better than, other institutions. The government does have one obvious advantage in this regard. Close co-operation with the Budget Department allows the Economic Affairs Department to take into account not yet announced government policies, such as various unemployment programmes, in the forecasts.

6.2. Structural and cyclical factors

As indicated above, macroeconomic forecasts of the Ministry of Finance have an anchor in the model for potential GDP, and there is an attempt to separate the effects resulting from a cyclical deviation from full employment levels. Such information is naturally of paramount importance for decisions on the government's counter-cyclical fiscal policy. By decomposing macroeconomic parameters into a structural and a cyclical component, it is furthermore possible to calculate a structural indicator of the government balance.

Cyclical forecasts are only made for a period of two years, considering the uncertainties related to such projections in a longer term. For the third additional year in the medium-term framework, actual GDP is assumed to converge towards potential GDP – in other words, the output gap will be closed in a three-year period. Revenue and expenditure forecasts for the third year will therefore be structural, i.e. full-employment values.

6.3. National Institute of Economic Research

In addition to the macroeconomic forecasts produced by the Ministry of Finance, the National Institute of Economic Research publishes quarterly independent forecasts on macroeconomic development and public finances. The institute also conducts research in the field of economics, and comments on the fiscal policy pursued by the government. The institute does not, however, have any formal role with regards to the budget process or the government's policies. Its function should rather be seen as an expert agency

for economic matters that could provide the government, and to a certain extent the public, with a second opinion on the macroeconomic development and in-depth analysis of issues related to public finances.

7. Expenditure forecasts

The use of a medium-term approach to budgeting requires access to expenditure forecasts of the highest quality. On the overall level, the government and Parliament have to be well informed about the development of expenditure for a number of years ahead in order to evaluate the room for new policy initiatives, or the need to reduce expenditure to ensure fiscal sustainability. In Sweden, this translates into a close monitoring of ceiling-restricted expenditure² to make certain that the expenditure ceiling is not exceeded. For individual sections of the budget or for individual appropriations, the government closely monitors expenditure to obtain early warning on a development that may need attention or a change of policy.

7.1. Five or six complete medium-term expenditure forecasts every year

Every year, the government administration produces between five and six complete forecasts of all central government expenditure, down to individual appropriations, in a three-year perspective. This means that the Minister of Finance and the government constantly have an updated picture of the expenditure development for the current year, the upcoming fiscal year and the two additional years. Expenditure forecasts for all four years are prepared together, and there are no differences in either the way forecasts for individual years are produced, nor in the amount of attention they receive. As much effort is put into preparing a correct forecast for the current fiscal year as for the third additional year. It should be pointed out, however, that there are slight variations in the objective for, and the focus of interest in, the forecasts for the different years.

For the current budget year, the overshadowing objective of monitoring expenditure is to avoid breaching the expenditure ceiling. Line ministries and the Ministry of Finance scrutinise the forecasts to assess the expected outcome and ensure a sufficient margin under the expenditure ceiling. An important input into the forecasts is the figures on budget execution. A report on budget execution is presented to the Ministry of Finance no later than two weeks after the end of each month. Naturally, in the beginning of the year, these figures are of limited value. As the year progresses, however, an extrapolation of the executed budget becomes an increasingly better estimate of the end-of-year outcome. Since for each appropriation the expenditure trend varies between months, the Ministry of Finance produces a **naïve forecast** for each appropriation

for the current year, which is merely a projection of executed figures where the monthly expenditure trends from previous years are taken into account.

For the upcoming fiscal years, expenditure forecasts give an indication of the resources necessary to honour previously made commitments and the fiscal effects of new initiatives proposed by the government. The point of departure for the budget preparation process is an assessment of the margin between forecast expenditure and the expenditure ceiling, which can be used for additional discretionary spending or, in the case of an insufficient or negative margin, which requires savings. To make such an evaluation, the initial forecast is based on an assumption that the policies already presented to Parliament will be continued. In other words, no changes in programmes that would lead to increased or decreased expenditure are included in the forecasts. The objective for producing such a **baseline assessment**³ is to be able to separate the effects of previously decided government policy from new policy initiatives. The baseline assessment is compared to the expenditure ceilings, and the government is provided with a margin that indicates the room for fiscal policy.

Once the process of preparing changes in government policies is initiated, the expenditure effects of new proposals are included in the forecasts. Since all three years are included, it may be the case that a programme can be fitted within the budget margin for the upcoming year, but not under the ceiling for the second or third additional years. The medium-term framework is hence an effective instrument for ensuring sustainable finances.

7.2. Expenditure forecasting involves the whole government administration

Expenditure forecasting is an exercise that involves all levels of the central government administration, from government agencies through line ministries to the Ministry of Finance. Forecasting is managed in the computerised budget management system, to which the whole administration has access. In this system, historical information on budget execution, actual budget figures, projected budget figures for the medium term, and available carry-over funds that affect resources available to agencies are recorded. With a full presentation of all relevant information it is easy to compare and scrutinise expenditure forecasts. The unified system also reduces the risk of error that inevitably arises when information is transferred from one system to another.

The schedule of the expenditure forecasting rounds is planned³ over a year in advance. In November or early December, the Ministry of Finance presents a synchronised timetable for all phases that are necessary for the production of expenditure forecasts. Apart from the agenda for the macroeconomic forecasts produced by the Economic Affairs Department, dates

are set for when government agencies should register their medium-term expenditure forecasts, when the line ministries' revision of these forecasts should be entered into the computerised budget management system, and when the Ministry of Finance's final forecast should be presented. Naturally, the forecasting rounds are linked to the budget process and the government's need for information on how expenditure is expected to develop.

As indicated in Section 6, all expenditure forecasts are based on a set of assumptions for main macroeconomic parameters. Once a new macroeconomic framework has been presented, this is registered in the computerised budget management system to ensure that all agencies and line ministries have access to the same assumptions, and that all forecasts are based on a consistent set of parameters. It should be pointed out, however, that expenditure forecasts are updated more frequently than the macroeconomic framework, and every forecasting round is not based on a fresh set of assumptions.

In a first stage of each forecasting round, government agencies are obliged to make a forecast of the expenditure for which they are responsible. This forecast is submitted to the responsible line ministry, where a reassessment is made and the line ministry's estimate is registered. This second stage is useful for detecting and correcting obvious mistakes in the agencies' forecasts. For major transfer systems, such as unemployment benefits, pensions, child benefits and various health-related benefits, line ministries often have their own forecasting models, which means that they are able to challenge the figures provided by the agencies. In these areas, there can be quite significant discrepancies between the agencies' and the line ministries' expenditure forecasts. In the third stage, line ministries' forecasts are scrutinised by the Budget Department in the Ministry of Finance. Apart from ensuring that there are no evident errors, there is usually room to make some readjustments to reduce the effects of a systemic tendency to overestimate administrative expenditure. The Budget Department pays close attention to expenditure for transfer payments since the changes in these systems may have a profound effect on expenditure.

7.3. National Financial Management Authority

In addition to the forecasts provided by the Ministry of Finance, a government agency – the National Financial Management Authority – has been given the task of producing revenue and expenditure forecasts at regular intervals. These forecasts are presented in the same structure and for the same period – the current year and the three upcoming years – as those of the Ministry of Finance. It is consequently possible to directly compare the forecasts and identify any differences. As a rule, the National Financial Management Authority and the Ministry of Finance make different interpretations and come to somewhat different conclusions about the

development of revenue and expenditure. The forecasts of the National Financial Management Authority are made public.

The production of complementary forecasts is a recognition of the importance of having access to reliable information on the development of government finances. By obtaining a second opinion, the quality of the government's own forecasts is believed to improve.

8. Revenue forecasts

Apart from expenditure, the government also forecasts the revenue side of the budget in a medium-term perspective. Revenue forecasts are produced by the Division for Public Finances under the Economic Affairs Department with the same periodicity as expenditure forecasts. The government is thus presented with a complete picture of revenue and expenditure development in the medium term on five or six occasions a year.

Revenues can be divided into taxes and other income sources. Taxes can further be divided into tax on labour income, tax on capital and tax on consumption and input goods. The methodology for forecasting each group of taxes differs to a large extent. The basis of all revenue forecasts is the same macroeconomic framework that is used for the expenditure forecasts. In addition, important information from the National Tax Board on current tax payments is used to continuously analyse the development of taxes. Current tax payments are reported monthly and consist, among other things, of firms' payments for employer's fees, payments for value-added taxes, and households' and firms' supplementary payments to avoid a large tax deficit at the end of the year. This highlights another difference between groups of taxes, namely whether they are settled monthly (*e.g.* the value-added tax) or settled in the yearly tax assessment (*e.g.* the personal and corporate income tax). For the latter group, employers and firms make preliminary tax payments each month, and these payments contain important information on the final tax in the tax assessment.

Some taxes are highly correlated with the development of macroeconomic variables. For example, the personal income tax is closely connected to the development of the wage bill, and the value-added tax is correlated with the development of private consumption. In other cases, the connection with the macroeconomic picture is weaker. This is especially the case for tax on capital such as the corporate income tax and the capital gains tax. The medium-term forecast of the corporate income tax is based on the operating surplus in the corporate sector. For the current year forecast, however, other information, such as the development of firms' results presented in their interim reports, is of high importance. The revenue forecasts also take into account new tax proposals and their estimated revenue effects.

As the binding restriction on central government finances consists of the expenditure ceiling, there is a slightly different focus in the revenue projections. An updated forecast of the revenues is necessary to monitor central and general government balances and the sustainability of public finances. The interest is therefore somewhat more focused on the medium term, and slightly less on the current year. Forecasts for individual revenue items, such as personal income tax, value-added tax or corporate income tax, can also give an important indication of economic performance.

9. Consistency issues

One of the main differences compared to the previous order is the explicit attempt to produce a **consistent** macroeconomic framework. A medium-term forecast of macroeconomic parameters cannot rely merely on historical development of GDP, inflation and unemployment. Certain assumptions on potential GDP and the natural unemployment level must be made. This approach represents a significant improvement compared to the previous order. Macroeconomic forecasts have become more sophisticated and reliable. In addition to the introduction of anchors to the macroeconomic forecasts, much effort has been spent on trying to take into account the effects of government policies on macroeconomic parameters.

9.1. Interdependency

A crucial aspect of producing credible forecasts is to take into account the interdependency of macroeconomic parameters and government revenue and expenditure. It is obvious that macroeconomic development affects government finances. A higher GDP growth will most likely lead to increased employment and a corresponding increase in income tax revenue. Higher incomes tend to increase consumption with a resulting increase in value-added tax. On the expenditure side, a drop in the unemployment level will reduce the government's expenditure for unemployment benefits. Virtually every expenditure item in the budget is affected in one way or another by the macroeconomic development. At the same time, macroeconomic development is, in its turn, affected by the budget. Government consumption and investment have a direct effect on the GDP level. Tax and expenditure programmes that change households' disposable income change consumption patterns. In addition, there are indirect behavioural effects of the tax and benefit systems that alter the labour supply and inter-temporal preferences. Although difficult, the effect of government policies on macroeconomic development has to be taken into account.

Much attention is given to the consistency of macroeconomic and revenue and expenditure forecasts in Sweden. The macroeconomic framework is updated repeatedly to ensure that government policies are taken into account. Naturally,

close co-operation between the Economic Affairs Department and the Budget Department is crucial for successful operation. The individuals responsible for macro forecasts and expenditure forecasts are often in direct contact with one another. As a rule, there is neither time nor room for any formal obstacles.

9.2. Consistent assumptions

There is yet another aspect of consistency. All revenue and expenditure items in the budget should be based on the same macroeconomic assumptions. Forecast inflation used to calculate the expenditure development for the government's wage bill or taxable pensions has to be identical to the assumption used to forecast income tax revenue. As discussed in section 6 above, this is ensured by issuing a set of assumptions to be used in each forecasting round. In reality, this is not always sufficient to guarantee that line ministries actually use the macroeconomic assumptions provided by the Economic Affairs Department. The Budget Department therefore has to scrutinise the underlying assumptions of the line ministries' forecasts.

On a slightly more complex level, it is also necessary to ensure consistency between the volumes in different transfer systems. The changes in the number of individuals that receive health benefits may affect the unemployment level, and *vice versa*. Historically, the number of individuals supported by some kind of transfer payment does not vary drastically, even though the volumes in individual transfer systems may fluctuate between years. The Budget Department, therefore, has to monitor the total volume in all transfer systems to ensure overall consistency.

10. The presentation in budget documents

The medium-term fiscal framework in Sweden affects virtually all aspects of budget preparation. All matters concerning macroeconomic development, central government revenue and expenditure and public finances include projections for a three-year period.

10.1. The budget bills

The government produces two main budget documents every year, the **Spring Fiscal Policy Bill**, which is submitted to Parliament on 15 April, and the **Budget Bill**, submitted to Parliament on 20 September. The Spring Fiscal Policy Bill presents the government's macroeconomic assessment and the development of public finances, and outlines fiscal policy and budget policy in the medium to long term. This document corresponds to what is sometimes labelled as a **pre-budget statement**. In the Budget Bill, the government proposes an expenditure ceiling for the third additional fiscal year, an allocation of expenditure to **expenditure areas**, and a division between appropriations for the upcoming fiscal year – together with a detailed description of objectives and expected

results for programmes and agencies – and financial commitments that stretch beyond the year for which the budget is proposed. In the Budget Bill, the government also submits for parliamentary endorsement the calculation of revenue for the upcoming fiscal year, the main direction for fiscal policy, and the preliminary allocation of expenditure to expenditure areas for the second and third additional fiscal years. As a rule, the Spring Fiscal Policy Bill and the Budget Bill also contain a **supplementary budget** for the current year.

In a formal sense, Parliament only approves the budget for the upcoming fiscal year. With the exception of the expenditure ceiling, which the government proposes for the third additional year, the budget is strictly annual. In both the Spring Fiscal Policy Bill and the Budget Bill, however, all information is presented in a three-year perspective. It is consequently possible to compare the government's projected fiscal development to the expenditure ceiling. Parliament is asked to endorse, in other words sanction without formally approving, the government's **preliminary** medium-term allocation of expenditure to 27 expenditure areas. In this way, the government seeks to anchor its medium-term budget policy at an early stage. The budget also contains the **estimated** levels of appropriations for the second and third additional years. This level of detail is however only presented as information.

10.2. Budget submissions

As an input into the budget preparation process, government agencies are required to transmit **budget submissions** to the government by 1 March. This document should include the agency's proposal for how its activities should be financed for the upcoming three-year period, together with a plan for the multi-year commitment that the agency has to enter into in order to ensure continuity and efficiency in its operations. The three-year perspective in the agencies' budget submissions is an indication that a medium-term approach is applied not only in the government's relation to Parliament but in its relation to subordinate agencies as well.

11. Conclusion

Since 1997, a medium-term fiscal framework has been applied to virtually all aspects of budget preparation in Sweden. A longer horizon than merely the current and the upcoming fiscal years has enabled a better fiscal discipline, and has created preconditions for appropriate and timely government policies. The medium-term outlook not only characterises the government's relationship to Parliament, but is also a central feature of the administration's planning horizon.

Experience from Sweden shows that a medium-term framework has to be **integrated** into all aspects of the budget process in order to be effective. Separated medium-term projections for macroeconomic and fiscal variables, presented alongside the actual budget, will only have a limited impact, if any,

on relevant decision-making procedures. A medium-term fiscal framework is an **aspect** of the budget process, not a complementary exercise parallel to the preparation of the actual budget.

In order to apply a medium-term fiscal framework in Sweden, it has been necessary to enhance the **capacity to make realistic and reliable forecasts** for macroeconomic parameters and revenue and expenditure development. In order for the government and Parliament to allow the medium-term development to affect decisions on public finances, it is vital that all forecasts are of the highest quality. Much effort has been put into ensuring that all forecasts are consistent with one another. In addition, the introduction of an integrated computerised budget management system has significantly improved the capacity to produce complete medium-term forecasts of all central government revenue and expenditure five or six times a year.

Notes

1. The reformed Swedish budget process is described in detail by Blöndal (2001).
2. Such ceiling-restricted expenditure includes all appropriations in the budget (except interest payments on government debt), the use of carry-over funds, and the expenditure for the old-age pension system outside the budget.
3. Sometimes a baseline assessment is defined as the extrapolation of **current year** policies. In Sweden, an alternative interpretation is used, in which **policies presented to Parliament** are used as the basis for the forecast. The baseline assessment in December is hence based on the policies in the government's Budget Bill, although this has not yet been approved by Parliament. The baseline assessment for the Budget Bill includes any policy changes that the government has announced in the Spring Fiscal Policy Bill, which is presented to Parliament in April, but have neither been approved nor come into effect.

Reference

Blöndal, J. (2001), "Budgeting in Sweden", *OECD Journal on Budgeting*, Volume 1, Number 1, OECD, Paris.

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