SWEDISH NATIONAL AUDIT OFFICE

RIR 2019:38
DATE: 2020-01-17

The fiscal policy framework – application by the Government in 2019

The fiscal policy framework aims to create a fundamental framework for effective fiscal policy. Budget policy that leads to high indebtedness and increasing interest expenditure risks crowding out important measures, redistributing welfare in an undesirable way and restricting stabilisation policy. Thus sustainable finances are fundamental for successful economic policy.

In the last economic upturn, public finances were strengthened from deficit to surplus. However, there are several risk factors that may impact finances negatively. For example, the demographic development indicates growing expenditure, while the prospects of increased tax income are negatively affected by the employment gap that exists between people born in Sweden and people born abroad. Unless the gap can be reduced, it will be more difficult to finance future expenditure increases.

In the light of the important role played by the framework and the risk factors that exist, the Swedish National Audit Office considers that periodic review of the Government's application of the fiscal policy framework is justified. This audit is based on the fiscal policy bills presented in 2019 and focuses on compliance and transparency of reporting.

Audit findings

Our overall conclusion is that the Government is in compliance with the framework and that the presentation in the fiscal policy bills essentially satisfies the requirements that may be made concerning transparent reporting. However, a number of actions could be undertaken to improve follow-up of the surplus target and the expenditure ceiling.

The Swedish NAO's assessment is based on the following findings.

Achievement of the fiscal policy targets

The surplus target concerns general government net lending, which is to average one third of a per cent of GDP over a business cycle. The indicator used to follow up the target points to net lending below the target level in 2019 and 2020, but these are not clear deviations. Consequently, there is no obligation for the Government to set out how a return to the target is to be achieved.

The debt anchor is a benchmark for the general government consolidated gross debt and is set at 35 per cent of GDP. The forecasts for 2019 and 2020 indicate a debt level slightly below the benchmark. As the level of debt is allowed to deviate by five percentage points from the target level, the Government does not need to explain what has caused the deviation and how it is to be dealt with.

The expenditure ceiling for central government means that the ceiling-restricted expenditure may not exceed an amount determined by the Riksdag three years earlier. A key purpose of the ceiling is to provide the basis for achieving the surplus target. We consider that the expenditure ceiling proposed by the Government for 2022 constitutes a reasonable basis for achieving the surplus target.

The municipal balance requirement implies that each municipality and county council must budget for a balance, unless there are exceptional grounds. Based on the Government's reporting, we conclude that the municipal sector as a whole is expected to achieve the municipal balance requirement in 2019 and 2020.

The fiscal stance follows the framework

In our opinion, fiscal policy for 2020 may be regarded as neutral and in line with the framework. The active fiscal policy proposed in the budget for 2020 reduces net lending by 0.6 per cent of potential GDP. However, this is offset by other factors that increase net lending by the same order of magnitude. A significant factor that strengthens net lending is the rules governing many welfare systems and the central government budget process. They mean that there is no automatic indexation of many transfers and other appropriations when the economy grows and prices rise.

Follow-up of the surplus target and expenditure ceiling could be improved

The surplus target is followed up using an indicator for the current and next budget years. Thus follow-up is based on forecasts and the indicator used, the structural budget balance, can be calculated in different ways. Since follow-up is based on uncertain calculations, we consider that forecast comparisons in the fiscal policy bills are central to following up the target. However, the account in the Budget Bill is not sufficient to explain the forecast differences that exist.

In the absence of information on the comparability of forecasts, it is difficult for an external evaluator to form a picture of the uncertainties that exist and whether the surplus target will be reached. We believe that the Government can develop its forecast comparisons by making better use of forecasts made by expert agencies. The National Institute of Economic Research and the National Financial Management Authority have good knowledge of the Swedish economy and public finances, making these agencies' forecasts particularly valuable for the follow-up.

In addition, it is unclear how the historical eight-year average used in the follow-up of the surplus target should be interpreted. For example, the Budget Bill does not show which target level the average for the period 2011–2018 should be compared against. As of the 2019 budget year, the surplus target was changed from one to a third of a per cent of GDP. In future bills the historical eight-year average will therefore include budget years with both the old and the new target level. We consider it necessary to clarify whether, and in that case how, this indicator is to be used in the ongoing follow-up.

The Government's proposed expenditure ceiling for 2022 is reported in accordance with the practice set out in the fiscal policy framework. However, the reasons for the proposal are not based on an account of the Government's view of how general government expenditure and the tax take should be developed in the long term. We have previously called for these reasons to be presented when the Government proposes levels of expenditure ceilings.

The Swedish National Audit Office's recommendations to the Government

- The Government should develop the reporting in the fiscal policy bills to explain more clearly the differences between the Government's and the expert agencies' forecasts of structural net lending and the GDP gap.
- The Government should clarify the context and the use of the historical eight-year average in the follow-up of the surplus target.
- The Government should justify its proposed expenditure ceilings by setting out how general government expenditure and the tax take should be developed in the long term.