



RiR 2017:32

Application of the fiscal policy framework

Summary and recommendations

Background

The Swedish National Audit Office regularly audits the fiscal policy bills and the central government annual report, focusing on the Government's application of the fiscal policy framework. The framework contains the fundamental principles that steer how fiscal policy is to be formulated in order to be long-term sustainable and transparent.

Transparent reporting is a condition for enabling external analysts to assess whether fiscal policy is conducted in accordance with the principles specified in the framework and approved by the Riksdag.

Purpose and delimitations

The overall purpose of the audit was to examine the Government's application of the fiscal policy framework in the 2016 Central Government Annual report, the 2017 Spring Fiscal Policy Bill and the 2018 Budget Bill. The audit focuses on two areas; transparency and compliance with the framework, and focuses on the following audit questions:

- Is the Government's reporting transparent in the documents audited?
- Is fiscal policy formulated in accordance with the fiscal policy framework?

The audit of the transparency of reporting focuses on public finances and the parts of the reporting on which the fiscal policy targets are based as well as the assessment of fiscal space and the proposed fiscal stance.

Audit findings

Transparency in the Government's reporting has improved

The state of public finances in 2016 and 2017 is considerably better than was predicted in the Budget Bills for the respective years. Net lending improved after the budget decisions by 1.9 and 1.2 per cent of GDP respectively. More than half of the improvement is due to unexpectedly high revenue from tax on capital and tax on consumption. Net lending for the years in question is now expected to be about 1 per cent of GDP. Reporting on public finances was developed in the 2016 central government annual report so that it is now shown more clearly why net lending improved after the budget was adopted.

The Government expects net lending in the public sector to remain at about 1 per cent of GDP in the next two years and then strengthen to 1.5 per cent of GDP in 2020. The Swedish National Audit Office notes that net lending in the latter part of the forecast period (2019–2020) is not strengthened to the extent as is often the case in the fiscal policy bills. This is because the Government announced new reforms also for 2019–2020 in this year's Budget Bill. The reforms counteract the budget consolidation that arises as a consequence of the budget calculation principles used in the latter part of the forecast.

The accounts in the Budget Bill now show how the Government views priority needs up to 2020 that arise due to an increased demographic need for local government welfare services. According to the Government, the announced increases in government grants in 2019 and 2020 will enable the local government sector to increase expenditure in pace with the demographic need without having to increase municipal tax or make cutbacks. The Swedish NAO considers that this has increased transparency in the decision support material.

However, the Government's reporting of local government sector expenditure is meagre. Previous bills contained a calculation of how much expenditure needs to increase to meet the demographic need for welfare services. This calculation is not presented in the 2018 Budget Bill. It is needed for example to be able to assess whether the Government's position concerning demographically driven expenditure is well-founded.

The local government sector's demographic expenditure pressure should be made clearer

The Government makes an annual assessment of the long-term sustainability of fiscal policy. The purpose is to identify potential risks of future imbalances in public finances at an early stage. Transparency in the Government's reporting is generally good but there is no sub-sector perspective that presents the central and local government sectors separately.

The demographic trend in the 2020s will entail continued growth in expenditure on welfare services for which municipalities and county councils are responsible. The Government's sustainability assessment, and its presentation, is based on the public sector as a whole and consequently in the Government's calculations government grants are adjusted so that the local government sector achieves sound financial management.

If staffing ratios in welfare services are to remain unchanged, the government grants need to increase on average by just over SEK 20 billion per year in the 2020s. This corresponds to an increase in government grants of just over SEK 200 billion between 2020 and 2030 according to the calculations the Swedish NAO has had access to, which are not expressly presented in the fiscal policy bills. A presentation broken down by central and local government sectors would promote a discussion both of the need for fiscal policy priorities and the future focus of tax policy.

Greater need for forecast comparisons in future

The surplus target is monitored with the help of several indicators. The structural budget balance, i.e. net lending adjusted for cyclical and non-recurring effects, is one of these indicators. When the transition is made to a new lower proposed target level as of 2019, the structural budget balance will play a more important role in monitoring the surplus target.

In theory the structural budget balance is an appropriate indicator, but there are several problems of application. There is no outcome for the structural budget balance and it can be calculated in several different ways, which may give different results. For example, the assessment of the economic situation (GDP-gap) is of central importance in the calculation. Bearing in mind the application problems it is therefore of great importance that the Government makes it clear what distinguishes their forecast of the structural balance from that of other analysts. The Government's forecast comparisons are brief and scanty in the bills audited, with few explanations as to why the forecasts differ.

In the 2018 Budget Bill the Government estimates that the structural budget balance as of 2016 is in line with the current surplus target and the new proposed target. After the Budget Bill the Government's expert agencies, the National Institute of Economic Research and the National Financial Management Authority, published forecasts that took into account the proposed policy. These show that their assessment of the structural budget balance for 2018 is below both the current and the new proposed level for the surplus target.

A more detailed account of what differentiates the structural budget balance forecasts will be important in future as differences in relation to other analysts may exist. This may be the case already in next year's Spring Fiscal Policy Bill if the forecast differences arising after publication of the Budget Bill remain. A more detailed description of the differences is also important in that the structural budget balance is proposed as the only indicator in the forward-looking follow-up of the surplus target. It is central for confidence in fiscal policy and for compliance with the fiscal policy framework that the Government's assessments do not deviate from other forecasters, in particular the expert agencies, unless the Government clearly explains why.

Unclear how fiscal policy is considered in relation to the economic situation

The Budget Bill contains new reforms totalling SEK 40 billion for 2018. General government net lending in 2018 is weakened by this figure but an active fiscal policy adopted previously helps prevent net lending being weakened quite so much.

The change in the structural budget balance is an indicator of the effect of fiscal policy on demand and is a measure of the fiscal stance. Apart from active fiscal policy, the structural budget balance is also influenced by other factors. The fiscal stance, despite proposed new reforms totalling SEK 40 billion, can be regarded as neutral in 2018.

However, there is no description in the Budget Bill concerning how the size of the active fiscal policy and the fiscal stance have been considered in relation to the economic situation. In addition there is no description of how the Government has dealt with uncertainties and risks in its assessment of the fiscal space. The Swedish NAO finds this remarkable. Such descriptions have been given in some previous fiscal policy bills. Nor is it shown how the current situation with very low interest rates has been taken into consideration when formulating fiscal policy. Consequently, the Swedish NAO considers that the Government's reporting lacks several components that would enable an external analyst to determine whether the proposed policy is formulated in accordance with the fiscal policy framework.

The steering effect of the expenditure ceiling should be strengthened

The expenditure ceilings that are adopted and proposed, together with the Government's forecast for ceiling-restricted expenditure, mean large budgeting margins going forward. If the margins are not used to increase expenditure in future years, it will mean that the expenditure ceilings are set so high that they lose their steering effect. However, if the margins are utilised, revenue enhancements will be needed to achieve the surplus target. As before, the Swedish NAO considers that the Government should explain proposed new expenditure ceilings by presenting how it views the balance between general government expenditure and the long-term focus of tax policy. The Swedish NAO awaits the Government's response to the Riksdag's announcement regarding how the level of the expenditure ceiling should be set so that it regains its steering effect.

The local government balanced budget requirement should be followed up against outcome

In its follow-up of the local government balanced budget requirement the Government presents the sector net profit before extraordinary items instead of the balanced budget requirement outcome. The balanced budget outcome and the net profit before extraordinary items is by and large the same thing, but there are differences that may amount to many billions of kronor in individual years. Unlike net profit before extraordinary items, the balanced budget requirement outcome takes into consideration the fact that municipalities and county councils are able to reserve parts of a positive outcome that can later be used to smooth outcome over an economic cycle. The Swedish NAO sees no reason for the Government to choose to report the net profit before extraordinary items instead of the balanced budget requirement outcome when following up the local government balanced budget requirement.

The Swedish NAO's recommendations to the Government

- The Government should consider also reporting the performance of the central and local government sector to 2030 in its long-term sustainability calculations. At present the public sector as a whole is reported, which means that it is not shown that government grants are increasing by just over SEK 20 billion per year during the 2020s. An account broken down by central and local government sectors would better illustrate the question of how the welfare commitment should be financed.

- In the fiscal policy bills the Government should develop its reporting of how the Government's forecasts – primarily the structural budget balance – relate to those of other forecasters, in particular the Government's expert agencies. In future this will be even more important as the structural budget balance will constitute the only indicator for the forward-looking follow-up of the surplus target. Enhanced reporting should reduce the risk of the Government making assessments of the structural budget balance that systematically (over time) deviate from those of the expert agencies.
- The Government should explain how the size of active fiscal policy and the fiscal stance have been considered in relation to the economic situation.
- The Government should follow up the local government balanced budget requirement against outcome.