



RIKSREVISIONEN

Summary:

Application of the fiscal policy framework

RiR 2011:30

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The Swedish National Audit Office has examined whether the government's assessment of the scope for reform in the budget bill for 2012 conforms to the principles of the fiscal policy framework and whether the assessment is being reported in a transparent manner.

Background to the audit

Reason: Since the late 1990s, Swedish fiscal policy has been steered by a fiscal policy framework involving specific goals. The framework was designed in the light of the acute crises affecting government finances earlier that decade. The basic purpose of the framework is to ensure stability and the long-term sustainability of public finances.

In a number of audits, the Swedish National Audit Office has focused on how Swedish governments have applied the fiscal policy framework. The fiscal bills since 2008 have been regularly audited, primarily from this point of view. The audit of the budget bill for 2012 forms part of this regular work.

Aim: The overall aim is to examine whether the focus of fiscal policy as presented in the budget bill for 2012 has been designed in accordance with the fiscal policy framework. The discussion is primarily based on the government's reported assessment of the scope for reform.

Implementation: The audit is based on Government Communication 2010/11:79 *Ramverk för finanspolitiken* [Framework for fiscal policy] and examines whether the government has conformed to the principles of the Communication when designing and presenting fiscal policy in the budget bill. The audit focuses more specifically on the government's assessment of the so-called scope for reform, which plays a decisive role in the design of fiscal policy. The scope for reform is the scope in the State budget that can be utilised for permanent tax reductions and expenditure increases or the need for consolidation measures. Even though assessing the scope for reform is to some extent a political consideration, the assessment must be consistent with the overall goals and principles of fiscal policy.

The audit is based mainly on document studies.

The results of the audit

The government estimates that SEK 15 billion constitutes a well-balanced scope for reform for the next budget year, taking the surplus target for the public sector as a starting point and taking into consideration the uncertainty in the assessment, the risk scenario, the economic situation and the long-term sustainability of fiscal policy.

The Swedish National Audit Office notes that the government's assessment of the scope for reform in the budget bill for 2012 is more structured and is described in more detail than previously. The presentation largely conforms to the principles and starting points that, as had been stated previously, would apply when assessing the scope for reform. At the same time, there is room for improvement in the transparency of the presentation.

The design of the surplus target as an average "over a business cycle" means that the indicators used when checking against the target and the interpretation of those indicators become important. Transparent reporting is therefore of vital importance for the understanding of the proposed fiscal policy.

One important question with regard to interpretation is how to deal with the risk that business cycles may not be symmetrically distributed around the long-term potential level of production in the economy. The government – and other analysts – argue that such an asymmetry does exist, with the main emphasis on the fact that the downturns are longer and more pronounced than the corresponding upturns. This would then mean that the cyclically-adjusted indicators used when checking the surplus target are misleading. Since the government does not report on the extent of the expected asymmetry, it is unclear whether the cyclically-adjusted indicators can be measured against the one per-cent surplus target at all.

When assessing the scope for reform, the government ascribes great importance to the uncertainty concerning future economic progress and argues that it is now all the more vital to have safety margins. However, as far as the reasoning with regard to risks is concerned, we should bear in mind that there is already a buffer built into the level chosen for the surplus target. That buffer is indeed intended to "be able to meet sharp downturns in the economy without any risk that the increase in indebtedness will become unsustainable"¹ and is one of the key reasons for the surplus target.

The Swedish National Audit Office states that there is a risk that the government's approach involving an "overall assessment" of the scope for reform will lead to less transparency in fiscal policy. An overall assessment makes it easy to justify any departure from the fiscal policy framework. Transparency would be improved if such departures were more clearly distinguished between those due to the basis for calculation – including the assessment of future economic progress - and those due to political considerations. The scope for reform arrived at by the government in the overall assessment only relates to a subset of the potential scope for reform that is possible using the surplus target and expenditure ceiling as starting points. The size of the additional safety margin that the government expects to have is not clearly stated. Therefore, it becomes difficult to understand what considerations have been taken into account and it is also difficult to evaluate how reasonable the government's assessment is.

Furthermore, the Swedish National Audit Office has found that even small differences in the forecast for potential GDP² can be important for monitoring fiscal policy and for the ability to understand the considerations leading to the assessment of the scope for reform under the proposed expenditure ceiling. Few reasons for the assumptions behind the forecast for potential GDP are given in the budget bill. The Swedish National Audit Office considers that, in order to achieve clarity and transparency when presenting fiscal policy, it is important for the variables used in assessments and the reasons for the proposed policy to be presented in clear, unequivocal terms.

Recommendations

To further increase transparency in fiscal policy, in future fiscal bills the government should present an estimated potential scope for reform or measures to strengthen the budget on the basis of the budget policy framework. If the government considers that an additional safety margin is needed to manage risks, its effect on the scope for

¹ Government Communication 2010/11:79, page 19.

² Potential GDP is the level of overall production that is consistent with stable inflation.

reform should be quantified. When checking the public sector net lending against the surplus target, the government should clearly report on the extent to which an asymmetrical output gap is being taken into consideration.

In future fiscal bills, the government should present a table for potential GDP in fixed and variable prices. Major differences compared to previous bills should be explained.