



## Summary:

# Audit of the Budget Bill for 2017

### *Summary and recommendations*

The Swedish NAO has regularly audited the budget bills. The purpose has been to study the Government's accounting in view of the fact that the budget bills constitute an important basis for Riksdag decisions. The audit of the Budget Bill for 2017 builds on issues of transparency and the Government's application of the fiscal policy framework.

Transparency in reporting of fiscal policy is basic from the point of view of democracy but it is also decisive for confidence in fiscal policy. The Swedish National Audit Office considers that this reporting should be understandable and contain relevant information necessary to enable independent evaluation of the Government's overall assessment. This means for example that it must be possible, using the specified premises presented, to evaluate the plausibility of the Government's assessments. Moreover, the audit of the Budget Bill for 2017 is based on the Budget Act (2011:203) and its provisions concerning fiscal policy targets and the Government Communication 2010/11:79, the Fiscal Policy Framework.

### **Audit findings**

#### *Clarify the implications of the forecasts*

Net lending was substantially reinforced in 2015, according to the Government as a consequence of high growth and responsible fiscal policy. A contributory factor not mentioned by the Government is the rise in household capital gains, which increased by just over SEK 50 billion in 2015, which in itself meant increased tax revenue of almost SEK 15 billion. This year and next year public sector net lending is instead weakened. This is partly due to migration-related expenditure and the Government's unfunded measures in the Budget Bill for 2017. But household capital gains have some significance even for 2016 and 2017. The Government's forecasting method is based on capital gains rapidly returning to the historical average as a percentage of GDP. This means that in the Government's forecast for 2016-2017 household capital gains fall. This forecast method is prudent in the current situation. At the same time the assumption is difficult to reconcile

with other income and expenditure forecasts, since it assumes falling stock market prices, which the macroeconomic forecasts do not.

In the longer term, 2018–2020, general government net lending is strengthened in the Government's forecast as a result of the calculation assumptions applied. These assumptions give a weak increase in expenditure, which, if realised, means lower staffing ratios in publicly funded welfare services and a lower replacement rate in central government transfers to households. This is not clearly shown in the data for decision-making submitted to the Riksdag, which according to the Swedish NAO is a deficiency. The Government makes an effort to describe the implication of the forecast method for the municipal sector. The Government's calculations show that the demographic need for municipal consumption will be considerably higher in coming years than it has been in the last decade and that the forecast municipal consumption on which the budget is based does not reach up to the demographic need. The Swedish NAO calculates, based on the budget documentation, that the equivalent of SEK 50 billion must be added to the municipal sector by 2020 to enable it to meet the demographic need for healthcare, education and social services in the framework of the municipal balanced budget requirement, to avoid the need to make cuts in the quality of welfare. The Government does not specify if or how this will be done. The resources of the municipal sector can be strengthened either via increased government grants or through municipal tax increases. If the Government supplies additional funds by increasing government grants, this will require reinforcements of the same order in other parts of the budget to achieve the Government's forecast for public sector net lending. If the municipalities are to manage the funding themselves instead, this means municipal tax increases equivalent to SEK 2 by 2020.

The Swedish NAO would like to see a better description of the implications of the forecasts through the Government regularly reporting alternative scenarios. The alternative calculation described above for the municipal sector is a model that can be transferred to other areas, such as central government consumption and central government transfers. In the opinion of the Swedish NAO, these calculations could promote a discussion on future fiscal policy and facilitate reasoning concerning both the expenditure ceiling and the surplus target. However, the Swedish NAO does not mean that the basic budget calculation should be changed, since there are budgetary grounds for the current design.

### *Unclear description of fiscal policy and its focus*

The focus of fiscal policy is described in two different ways in the Budget Bill – as active fiscal policy and the change in the structural budget balance.

Active fiscal policy includes the effect on general government net lending of measures already decided and proposed in the Budget Bill. The active policy is described in the Budget Bill as neutral, i.e. the active policy does not contribute to the fall in net lending in 2017. This is partly because measures already decided will have a contractionary effect in 2017, partly because expansive measures are proposed for 2016, which reduces the difference between 2016 and 2017. At the same time, the measures in the Budget Bill for 2017 will weaken net lending by SEK 17 billion in 2017. It is difficult to follow the Government's reporting of active fiscal policy. In addition, the assessment suffers from severe problems of definition. On the one hand, the reduced appropriation to the Swedish Migration Agency for 2016 for example, is not counted as active policy, while on the other hand, its counterpart in the form of increases in development aid (reduced budget adjustments for development aid) is included as active fiscal policy. All in all, the Swedish NAO notes that the term active fiscal policy does not bring any clarity to the question of the focus of fiscal policy.

The focus of fiscal policy can also be described on the basis of the change in the general government structural budget balance, i.e. net lending adjusted for direct cyclical effects and for some one-off effects. This measurement is not subject to the same problems of definition as active policy. The structural budget balance will fall in 2017, which indicates that fiscal policy is expansive. The Government also forecasts a fall in the structural budget balance adjusted for migration expenditure, which will also fall. Hence the policy is expansive, measured on the basis of the structural budget balance, even when adjusted for the unusually high migration-related expenditure.

### *Difficult to find support for unfunded measures in 2017*

Both general government net lending and structural budget balance are below the surplus target level (even the new target, see also the section below). At the same time the economy will strengthen according to the Government's forecast and resource utilisation will be somewhat above normal in 2017. In these circumstances, the premise of the fiscal policy framework is that measures should be taken to strengthen general government net lending. One factor behind the weak net lending is the unusually high migration-related expenditure. The restraint in migration policy implemented in winter 2015/16 meant a more restrained fiscal policy to the extent that the Government's forecast for general government net lending in the next few years is considerably higher

than before. It would not be in line with the intentions of the framework to fully fund the temporarily high migration expenditure. However, migration expenditure does not solely explain the fall in the structural budget balance in 2017. The Government presents no arguments for actively weakening net lending in 2017. The measures in the Budget Bill contribute to the weakening of net lending in 2017. The Swedish NAO therefore considers that it is difficult to find support in the fiscal policy framework for taking unfunded measures in 2017. In the opinion of the Swedish NAO, it would be more in line with the framework to wait with unfunded measures until the structural budget balance exceeds the new target level of 1/3 per cent of GDP, which is expected to be in 2019.

### *A credible plan for fiscal policy in 2018 is needed*

Monitoring the surplus target is complicated in the present situation, bearing in mind that there is broad parliamentary support for transferring to a new surplus target in 2019. The change means that the surplus target will be adjusted so that general government net lending is to be an average of 1/3 per cent of GDP over a business cycle. The adjustment of the target level contributes to the lack of clarity of the Government's forward-looking follow-up of the surplus target – it is not clear which target the Government intends to meet. It is important for the credibility and predictability of fiscal policy that decisions on introducing the new target are made without delay so that the lack of clarity as to which target applies can be eliminated. Clear information is also needed for fiscal policy in 2018, when the new target will not apply, according to the inquiry proposals. The Swedish NAO considers that the Government, in connection with the submission of the proposed new surplus target to the Riksdag, should specify the focus of fiscal policy for 2018 in the form of a benchmark for the general government structural budget balance that indicates an adaptation to the new target. This declaration of intent would be valuable for the predictability of fiscal policy. The Government should also discuss the circumstances that could justify any deviation. This should then be followed up in the Budget Bill for 2018.

### *The expenditure ceiling indicates the need for future revenue enhancements*

The expenditure ceilings that are approved and proposed, together with the Government's forecast for ceiling-restricted expenditures, mean that the budgeting margins will be great going forward. The Budget Bill does not bring clarity to how the Government regards this. If the margins are not used to increase expenditure in coming years, it means that the expenditure ceilings are set so high that they lose their steering effect. If the margins are utilised instead – for example to offset the drop in standard of the

forecasts – a need will arise to raise revenues to fund this. The need for funding decreases, however, if it is decided to transfer to the new surplus target. But if the budget margins are utilised by 2019, about SEK 45 billion will be required in increased revenues to achieve the new surplus target.

### *Develop sustainability calculations*

The Government regularly calculates the sustainability of public finances. These calculations are intended to establish whether current tax rates can finance the existing public commitment in the long term. The sustainability calculations cover a long period and build on many simplified assumptions. Indicators are frequently used – for example what is termed the S2 indicator – which summarise sustainability in one figure. One disadvantage of that indicator is that it does not express whether any lack of sustainability is due to development in the short term or due to problems expected to arise several decades into the future. The Swedish NAO therefore recommends that the Government makes an analysis to show the significance for sustainability problems of general government net lending in various periods of time.

The alternative scenarios for developments up to 2020 called for above could also be used to develop the long-term sustainability calculations. These calculations are now based on the budget's ordinary forecast, and the assumption of a "maintained public commitment" is only used after 2020. A maintained public commitment means unchanged staffing ratios in publicly funded services and constant replacement rates in central government transfers. Hence the Government uses different calculation assumptions, with different implications for public finances, for the years to 2020 and the years thereafter. The 2020 starting point, that is the assumption to be retained in the calculations, is of great importance for the results. The assumptions behind the ordinary forecast to 2020 mean that staffing ratios in public sector services and replacement rates in the transfer systems will fall. Thus the sustainability calculations do not answer the question of whether today's tax rates can fund the *existing* public commitment. The Government should therefore develop the sustainability calculations with an alternative scenario in which the assumption of a maintained public commitment applies from the first year after the budget year, i.e. 2018 at present.

A "debt anchor", proposed to apply from 2019, will be tied to the new surplus target, which specifies that the general government gross debt (the Maastricht debt) must approach 35 per cent of GDP. The Government should take a position on this in the long-term calculations. The Swedish NAO therefore recommends that the Government, in the context of the long-term calculations, calculates how fiscal policy needs to be adapted to achieve the debt anchor's level in the long term.

### *Important to take into account public finance risks*

In a forward-looking perspective there are a number of public finance risks. Increased demand for public services, increased personnel provision problems in the public sector, reception of asylum seekers, the security policy situation, as well as risks linked to the pension system, the housing market and financial stability are some of the risks that, if they materialise, could put pressure on public finances. In the opinion of the Swedish NAO, it is important that the Government takes these risks into account. According to the Swedish NAO, an improved analysis of public sector financial risks from a forward-looking perspective of 10–15 years should form a central part of both the budget statement and the guidelines chapter of the Spring Fiscal Policy Bill. The greater the risks, the greater the need may be to guarantee buffers in public finances to be able to deal with temporary expenditure hikes. For risks that, if realised, would instead mean major permanent expenditure increases, it is important that the Government has presented documentation in good time and in an orderly manner on which to base discussions on priorities and funding.

### **The Swedish NAO's recommendations to the Government**

- The Government should present alternative scenarios in the budget and fiscal policy bills that describe public sector financial development assuming maintenance of the public commitment in the medium term, i.e. for the three years following the budget year in question, which is normally part of the budget calculations. These scenarios, together with the ordinary forecasts, can form the basis for the discussion on formulation of future fiscal policy.
- In connection with the proposal to the Riksdag for a new surplus target, the Government should also specify a benchmark for the general government structural budget balance for 2018. This is important for the credibility and transparency of fiscal policy, since the new surplus target will probably not come into force until 2019. The benchmark for 2018 should indicate an adaptation towards the new surplus target. The Government should also report the circumstances that may justify a deviation from the benchmark.
- Arguments for the new expenditure ceiling should include the Government's view of the balance between general government expenditure and the long-term focus of tax policy. In connection with this, the Government should give its view of how the public commitment should be developed in the longer term.
- The Government should provide an analysis of the significance of general government net lending in different periods for any estimated sustainability

problem. When the new surplus target level has been determined, the Government should calculate how fiscal policy needs to be adapted to achieve the debt anchor in the long term. The alternative scenarios with maintained public commitment in the medium term called for above should also be used to assess how this affects the conclusion on sustainability of fiscal policy.

- In the budget and fiscal policy bills the Government should provide an analysis of material public financial risks in a ten to fifteen years perspective. The analysis should aim, in good time and in an orderly manner, to investigate, discuss and assess the significance of the risks for the need for buffers, priorities and funding.