2020-11-27

The expenditure ceiling
– different roles in different times

Summary and recommendations

The Swedish National Audit Office (Swedish NAO) has audited the application of the expenditure ceiling. The expenditure ceiling was introduced in 1997 and means that central government expenditure may not exceed an amount determined by the Riksdag three years earlier. The overall conclusion is that the expenditure ceiling is mainly applied in accordance with the fiscal policy framework. However, there are deficiencies in the Government's arguments for expenditure ceilings. The Swedish NAO therefore recommends that the Government improve its reporting so as to help reduce uncertainty concerning the future design of fiscal policy and to strengthen confidence in long-term sustainable finances.

The audit is part of cooperation between several European Supreme Audit Institutions. The Swedish findings are presented in this report. The Swedish NAO's audit of the Government's crisis management, including application of the expenditure ceiling, in relation to the fiscal policy framework is presented in the performance audit report *The fiscal policy framework – application by the Government in 2020.*

Audit findings

The function of the expenditure ceiling has varied over time

The fiscal policy framework with surplus target and expenditure ceiling provides scope for a policy aimed at higher as well as lower public expenditure and tax take. The Swedish NAO has identified four phases in the use of the expenditure ceiling. Initially, during budget consolidation, there was a strong emphasis on reducing central government expenditure's share of GDP, known as the expenditure ceiling quota. This was toned down when public finances were healthy in the early 2000s. In the third phase, during the Alliance Government, the ambition was again to clearly reduce the expenditure ceiling quota. Since 2014, the Government's starting point has been that the expenditure ceiling quota should be largely unchanged. The expenditure ceiling has had a disciplining effect on the expenditure trend, partly because the ceiling has been a restriction in budget work, and partly because the ceiling indirectly required improved expenditure control.

The budgeting margin is large but cost control is good

When the Government keeps the expenditure ceiling quota stable, the difference between the expenditure ceiling and ceiling-restricted expenditure, the so-called budgeting margin, will automatically be large. This is due to the budgetary rules that govern the upward adjustment of central government expenditure. The forecast is made for three years, but some of the ceiling-restricted expenditures are not adjusted upwards at the same rate as the economy is growing and others remain unchanged in nominal terms in the coming years. The ceiling-restricted expenditures therefore grow slower than GDP in the forecasts, while the nominal expenditure ceiling must increase in line with GDP if the expenditure ceiling quota is to remain unchanged.

Several actors, including the Swedish NAO and the Riksdag, have pointed out that there is a risk that a large budgeting margin does not have a steering effect on the development of expenditure. The Swedish NAO notes in this audit that the steering effect of the expenditure ceiling is more functional when the intention is to reduce the central government expenditure's share of the economy. When the Government keeps the share of government spending stable, the expenditure ceiling will have a more passive function with a greater acceptance of higher expenditure development than originally forecasted. This entails a space that can be used for example for reforms.

A large budgeting margin underlines the requirements for good expenditure control. The expenditure control becomes a first line of defence, while the expenditure ceiling can be described as a far blocking when the margin is large. The Swedish NAO considers that there is a well-functioning follow-up of ceiling-restricted expenditure. The process of monitoring expenditure is well-founded and the forecast errors in a one year perspective are within the framework of what can be designated as acceptable in relation to the fiscal policy framework's guideline. The audit also shows that in individual cases there are significant discrepancies between outcomes and forecasts made three years earlier, but that, on average, total expenditure was lower than forecasted, excluding new reforms. The expenditure ceiling is not a target but a restriction, and the utilisation of the budgeting margin must be checked against the surplus target. Every year in 2015-2019 on average almost SEK 40 billion of the margin was not used either.

There are deficiencies in the Government's arguments for expenditure ceilings

The expenditure ceiling and other objectives of public finances have been mutually dependent since their introduction in the late 1990s. The expenditure ceiling is decided for a period three years ahead and constitutes an orientation for the level of expenditure, and hence the tax take, in the medium term. The audit shows that the Government's reporting of the proposed expenditure ceiling has varied over time. It has not always been clear what steers the Government's choice of level for the coming year's expenditure ceiling. Nor is it clear what tax take is needed for the level of expenditure to be consistent with the surplus target in the medium term.

Recommendations

The audit shows that there are deficiencies in the Government's arguments for expenditure ceilings. The Swedish NAO therefore makes the following recommendation:

- The Government should clearly present the principles and considerations that govern the proposed expenditure ceiling. The Government's view of the development of public expenditure and tax take in the longer term should be clear. This should be stated in any Government Bill in which the Government assesses or proposes a level for the expenditure ceiling to the Riksdag.