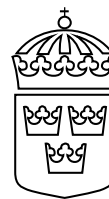


THE SWEDISH FISCAL POLICY FRAMEWORK



Government Offices of Sweden
Ministry of Finance

Regeringens skrivelse 2017/18:207



Fiscal policy framework

Skr.
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The Government presents this Communication to the Riksdag.

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Main content of the Communication

This Communication sets out the fiscal policy framework. The framework consists of a number of targets and principles that steer the design of fiscal policy and that are intended to ensure the long-term sustainability and transparency of fiscal policy. Some of these targets and principles are regulated by law, while others are based on the practice that has gradually evolved since the crisis in central government finances in the 1990s.

The main purpose of this Communication is to give a summary description of the fiscal policy framework (taking account of the changes made since 2011). When the Government describes how it intends to apply the fiscal policy framework, this helps to strengthen confidence in the design and reporting of fiscal policy. Greater confidence makes it more likely that fiscal policy will have the intended effect. The Communication is part of the work of the Government to strengthen the fiscal policy framework.

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The fiscal policy framework consists of a number of targets and principles that are mainly intended to ensure the long-term sustainability and transparency of fiscal policy. Some parts of the framework are regulated by legislation, while others are a result of the practice that has evolved since the crisis in central government finances in the early 1990s. The fiscal policy framework includes a surplus target for general government net lending. The surplus target is supported by a debt anchor for the general government consolidated gross debt, the “Maastricht debt”. The framework also includes an expenditure ceiling for central government expenditure (excluding interest on the central government debt) and expenditure in the old age pension system, as well as a local government balanced budget requirement. The budgetary policy targets, i.e. the surplus target, the debt anchor, the expenditure ceiling and the local government balanced budget requirement make up the central parts of the fiscal policy framework along with a stringent central government budget process, external monitoring and transparency.

Surplus target

The Budget Act (2011:203) requires the Government to propose a target for general government net lending (surplus target). The Riksdag (Swedish Parliament) has determined that as of 2019 the level of the surplus target will be an average of 0.33 per cent of GDP over an economic cycle. A comparison of general government net lending with the surplus target is used to assess the size of any fiscal space available from a forward-looking perspective or the need for measures to reinforce the budget. Since the economic situation affects net lending, this comparison is made on the basis of an estimate of the structural balance. A backward-looking eight-year average of actual net lending is used to evaluate *ex post* whether the surplus target has been achieved.

There is a deviation from the surplus target if the structural balance in the present or next year deviates clearly from the target level. When a target deviation is established, the Government has to give an account of how a return will be made to the target. The plan for returning to the target has to be timed and to normally start in the next budget year. When the economy is in balance, a target deviation should, in principle, decrease at the same rate as is normal in the absence of active political decisions. However, resource utilisation should also be taken into account.

A surplus target, once adopted, remains in place, but should be reviewed in every second electoral term. The conclusions of the review should be widely agreed among the parties in the Riksdag in order to safeguard the stability and credibility of the framework. A new surplus target should enter into force in the first year after an ordinary election. The review should take account of the development of the debt in relation to the debt anchor.

Expenditure ceiling

Following a proposal by the Government in the Budget Bill, the Riksdag sets an expenditure ceiling for the third year ahead, i.e. the second year after the budget year. The expenditure ceiling creates conditions for achieving the surplus target. The level of the expenditure ceiling should promote a desirable long-term development of central government expenditure. Along with the surplus target, the expenditure ceiling governs the level of the total tax take and helps to prevent a development in which the tax take must be increased gradually on account of insufficient control of expenditure.

The expenditure ceiling must not be circumvented by budgeting and reporting benefits, normally financed by appropriations, under income headings. A further main principle is that expenditure has to be reported in the year when it is intended to be used. Justifications have to be given for any departures from these principles. The practice is to have a 'budgeting margin' of a certain size under the expenditure ceiling. This margin is primarily intended to act as a buffer if expenditure does not grow as expected on account of the development of the economy.

Balanced budget requirement

To strengthen the budget process at local level, a balanced budget requirement for the local government sector has been applied since 2000. The balanced budget requirement states that every municipality and county council has to plan their budget so that revenue exceeds costs. A local authority may only budget for temporary deficits if there are extraordinary reasons. Municipalities and county councils also have to have sound economic management of their activities.

Stringent and well-organised central government budget process

A stringent and well-organised budgetary process is of central importance for achieving the targets of the fiscal policy framework. The expenditure ceiling is the overall restriction on the budget process in terms of total expenditure, while there is no corresponding restriction for income. In the budget process different expenditures are weighed against one another in a unified review and expenditure increases are examined in the light of a predetermined total fiscal space determined by the expenditure ceiling and the net lending target. The main principle is that expenditure increases in one expenditure area have to be covered by expenditure reductions in the same area.

It is also of central importance that the central government budget is transparent and comprehensive. The Government's proposed budget has to include all income and expenditure, as well as other payments that have an impact on the central government borrowing requirement (the "completeness principle"). Another main principle is that central

government income and expenditure are budgeted and reported gross under income headings and appropriations (the “gross principle”). This means that expenditure has to be reported on the expenditure side of the budget, while income has to be reported on the income side of the budget.

The Ministry of Finance coordinates budget work in the Government Offices and is responsible for the timetable and guidelines for this work and the process for the budget negotiations. However, each ministry is responsible for the provision of supporting information to enable the Government to set overall priorities between different sub-sectors of the general government and between different expenditure areas in the central government budget.

Debt anchor

A debt anchor for general government consolidated debt has been introduced as a complement to the surplus target. The debt anchor is not an operational target in the budget process, but is a benchmark for the desired medium-term level of the debt. The level of the debt anchor is 35 per cent of GDP. This level remains in place, but is reviewed in conjunction with the review of the level of the surplus target. The debt anchor is followed up each year in the spring fiscal policy bill. In the event of deviations of more than plus/minus 5 per cent of GDP from the debt anchor, the Government has to present a communication to the Riksdag setting out the reasons for the deviation and how the Government intends to deal with it.

External monitoring

A number of agencies are responsible for different aspects of fiscal policy monitoring at the national level; they include the Swedish Fiscal Policy Council, the National Institute of Economic Research, the National Financial Management Authority, and the Swedish National Audit Office. The Swedish Fiscal Policy Council has a special responsibility for analysing how well the Government is meeting the targets in the fiscal policy framework and whether the Government's fiscal policy is sustainable in the long term. Under the ordinance concerning its duties, the Council also has to make an annual assessment of whether there is a deviation from the surplus target. It also has to assess whether any deviation is justified and the rate at which there should be a return to the target. The Council's task is to make a well-founded overall assessment of the relevant circumstances on the basis of the principles for the monitoring of the surplus target that the Government and the Riksdag have backed.

As a member of the EU, Sweden has undertaken to follow the rules of the ‘Stability and Growth Pact’. The most central rules of the Pact are the permitted reference values for the general government budget deficit (3 per cent of GDP) and general government debt (60 per cent of GDP). Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States (Budgetary Framework Directive) was adopted in

Skr. 2017/18:207 November 2011. This Directive contains minimum requirements concerning the characteristics of the national budgetary frameworks; one purpose is to ensure Member States' compliance with obligations under the Treaty on the Functioning of the European Union with regard to avoiding excessive deficits. In addition, as part of the European Semester, there is an EU process for the monitoring of macroeconomic imbalances in the Member States, the 'Macroeconomic Imbalance Procedure'.

Openness and clarity

The spring fiscal policy bill outlines the direction of the Government's fiscal policy for the coming years. In that bill the Government also sets out its view of the current economic situation as well as the structural, stabilisation and redistribution policy challenges that policy is facing. It also contains a calculation of an appropriate expenditure ceiling for the third year ahead, a follow up of the targets in the fiscal policy framework and an assessment of the current fiscal space or the need for budget reinforcements. The spring fiscal policy bill also contains a follow up of the consolidated gross debt and how it relates to the debt anchor.

In the budget bill the Government presents specific policy proposals mainly for the coming budget year and also makes a proposal for the expenditure ceiling for the third year ahead. In both the spring fiscal policy bill and the budget bill the Government makes forecasts that look at least three years into the future. The forecasts have to be made using the best available methods and to be evaluated regularly.

The Government presents an analysis of the long-term sustainability of fiscal policy in the spring fiscal policy bill. The assessment of the long-term sustainability of fiscal policy is supplemented at regular intervals with generational analyses and long-term surveys.

The Government's annual report for central government follows up both the budget and the targets in the fiscal policy framework relative to the past budget year

2 Purpose of the Communication

The main purpose of this communication is to set out the rules and practice that make up the fiscal policy framework so as to thereby help to strengthen confidence that the design of fiscal policy is sustainable in the long term and that it is reported in a transparent way. The Communication is also intended to specify certain parts of the framework and the Government's application of it.

Broad political agreement on the fiscal policy framework can help to reduce uncertainty about the future design of the parts of fiscal policy covered by the framework. This was also the background to the agreement reached on amendments to the fiscal policy framework in conjunction with

the work of the Surplus Target Committee (SOU 2016:67).¹ Broad political agreement also helps to reduce uncertainty at changes of government about the direction of the parts of fiscal policy covered by the framework. In this way the framework can contribute to more stable macroeconomic development and reduce the risk of fiscal policy becoming a source of instability. The framework is also intended to clarify how Sweden's complies with the requirements of the EU's Stability and Growth Pact and the Budgetary Framework Directive.

The fundamental parts of the fiscal policy framework are regulated in law, specifically in the Instrument of Government, the Riksdag Act, the Budget Act and the Local Government Act (2017:725). To make clear which parts of the framework are regulated by law the relevant sections of the law are stated in this text. The other parts of the Communication can be viewed as an institutionalisation of the practice in fiscal policy that has gradually evolved over time since the mid-1990s. The Communication is therefore a summary of the applicable rules and practice. Since 2012 the Government monitors compliance with the fiscal policy framework continuously in the spring fiscal policy bill and the annual report for central government.

The fiscal policy framework is intended to function as an overall rudder for fiscal policy. However, the way fiscal policy is conducted may need to be developed over time on account of new experience and new conditions for policy.

As the fiscal policy framework has evolved, parts of practice have been codified in the Riksdag Act and the Budget Act. To some extent, the framework has also been adapted to the rules and EU-level regulations that steer the design of fiscal policy in the EU.

To increase the transparency of fiscal policy the Government set out the fiscal policy framework in 2011 in the government communication *Fiscal policy framework* (Comm. 2010/11:79, Committee Report 2010/11:FiU42, Riksdag Comm. 2010/11:316). Since then the framework has continued to evolve. Some parts of practice have been regulated in law, for example the reporting of forecasts and the handling of amendments to the central government budget (Govt Bill 2013/14:1, Committee Report 2013/14:FiU1, Riksdag Comm. 2013/14:56 and Govt Bill 2013/14:173, Committee Report 2013/14:KU46, Riksdag Comm. 2013/14:351). The level of the surplus target has been altered and a debt anchor has been introduced. At the same time the monitoring, follow-up and evaluation of the surplus target has been developed and the role of the Swedish Fiscal Policy Council has been strengthened (Govt Bill 2016/17:100, Committee Report 2016/17:FiU20, Riksdag Comm. 2016/17:6 349 and Govt Bill 2017/18:1, Committee Report 2017/18:FiU1, Riksdag Comm. 2017/18:54).

¹The Surplus Target Committee was a cross-party committee of inquiry appointed by the Government to review the target for general government net lending. Following an agreement across party blocks in June 2016 the Committee proposed minor alterations to the framework, including adjustment of the target level and monitoring of the surplus target. The Committee presented its final report to the Government on 30 September 2016.

Against the background of the evolution of the fiscal policy framework since 2011 there is reason to provide a new cohesive description of the framework.

3 Fiscal policy framework and the political decision-making process

A fiscal policy framework with credible targets creates predictability about the future and means that economic policy measures have more impact since businesses and households expect the budgetary policy targets to be achieved. To create credibility it is therefore important that measures are taken to handle any deviations from the targets. The Government gives an account both in the budget bill and in the spring fiscal policy bill of its view of the policy direction that is necessary to achieve the targets of the fiscal policy framework.

Fiscal political decisions are associated with a number of different choices and priorities. Politics is often based on negotiations in which the final outcome is the result of various compromises. So, fiscal policy decisions cannot be mechanical or regulated fully by a set of principles. However, since the crisis in public finances in the early 1990s there has been broad political agreement about the importance of sound public finances and how to use the fiscal policy framework to achieve this. There is also broad political agreement on a number of monitoring and reporting principles for openness and clarity in fiscal policy that contribute to greater transparency and to the fiscal policy being conducted having the intended effect.

However, it is difficult to specify in advance exactly what measures will be taken in the event of deviations from the targets. This is because account must be taken of multiple factors specific to a particular situation and because the budget is always subject to political considerations.

It is important to stress that the purpose of the fiscal policy framework is not to deprive democratically elected representatives of the right to decide fiscal policy. This policy reflects values. It is representatives of political parties who channel these values. The political system has a key role for mobilisation, debate, control and accountability in society, as well as for weighing opinions and perceptions together to arrive at holistic solutions. The ability to strike balances and make compromises between different interests helps to give fiscal policy its legitimacy. In a democracy the choice between alternative courses of action should therefore be made by democratically elected politicians, who will be accountable for their decisions in future elections. This means that fiscal policy decisions are also anchored in democracy. In general, therefore, fiscal policy will therefore be adapted to the specific parliamentary situation that is the base for the government of the day. It is neither possible nor desirable to replace the political decision-making process with mechanical rules, if the legitimacy of the decisions taken is to be retained. However, the political

system should use clear principles to make fiscal policy transparent, predictable and sustainable in the long-term. Skr. 2017/18:207

The fiscal policy decisions made by the Riksdag and the Government are thus reached by weighing together considerably more factors than are covered by the principles that make up the fiscal policy framework. But the fiscal policy framework is the most important rudder for making fiscal policy transparent, predictable and sustainable in the long-term.

4 Stringent central government budget process

The reformed central government budget process introduced in the mid-1990s is a central part of the fiscal policy framework. That reform meant that the budget was given a medium-term context and started from a top-down perspective, in which expenditures are weighed against one other and any expenditure increases are examined in relation to a predetermined financial space given by the expenditure ceiling and the surplus target. The budget process helps to prevent the sum of all budget proposals from exceeding what is compatible with a sustainable fiscal policy. The Ministry of Finance coordinates budget work in the Government Offices and is responsible for the timetable and guidelines for this work and the process for the budget negotiations. The Ministry of Finance is also responsible for the production of supporting information in the form of macroeconomic forecasts and assessments of the fiscal space or the need for budget reinforcements.

The medium-term character of the budget process makes it possible to separate the discussion of the fiscal space, the aggregate size of central government expenditure and a suitable level of the tax take from the discussion of specific needs and desirable new policy.

The Riksdag sets the level of the ceiling for central government expenditure at least three years in advance. However, the time perspectives in political discussions are often shorter than this, so expenditure claims for the third year ahead are not usually as distinct when the expenditure ceiling is fixed as when discussions are held on expenditure for the next budget year.

The budget process is regulated in the Instrument of Government, the Riksdag Act and the Budget Act. In mid-April the Government presents the spring fiscal policy bill to the Riksdag. This bill contains the Government's proposed guidelines for economic and fiscal policy, including an estimated level for the expenditure ceiling in the final year of the forecast period. The decisions of the Riksdag on the guidelines in the spring fiscal policy bill are then translated into a specific annual budget proposal in the autumn. The actual work on the budget is therefore concentrated to the budget bill (see section 10.1 for more information).

The Ministry of Finance constantly makes new assessments of economic developments, and this may lead to a need to amend parts of the budget during a budget year. The Government submits proposals for such

4.1 Preparation of the budget

The set procedures that form the basis for work in the Government Offices contribute to promoting effective and appropriate ways of working and ensure that the Offices can provide the Government with well-functioning support.

Budget work in the Government Offices is not regulated in law, and is decided by the Government and the Government Offices. The provisions regulating joint preparation in the Ordinance concerning the Duties of the Government Offices (1996:1515) (Sections 13 and 15) are fundamental to this work. Under the Ordinance, a matter that comes within the areas of activities of more than one ministry is processed in the ministry to which it mainly belongs and is prepared in consultation with the other ministers affected. Matters with financial implications for central government, or other economic consequences for public institutions, always have to be prepared with the Ministry of Finance, whose task it is to ensure that the overall result of the internal budget process is compatible with the targets given by the fiscal policy framework. The starting point for the budget process in the Government Offices is the preparation of a complete budget proposal where the proposed decisions are political but where the overall restrictions are the expenditure ceiling and the surplus target.

The budget process starts with base line assessments for the coming three years of income and expenditure in the central government budget and for the general government. The calculations are based on the applicable rules in the tax and expenditure systems. The Ministry of Finance analyses these assessments and examines whether they will allow the budgetary policy targets for the next few years to be achieved. If the assessment is that they cannot be achieved, proposals for budget reinforcements are drafted. All ministries are responsible for the provision of sufficient supporting information to set overall priorities between different sub-sectors of the general government and between different expenditure areas in the central government budget. The Ministry of Finance has a coordinating role in this work and is responsible for the consistency of the assessments between different areas.

4.2 Financing principles

The internal preparation work on the budget is also governed by a number of financing principles. These principles follow directly from decisions of the Riksdag on the expenditure ceiling, and the target for general government net lending and are important for ensuring the long-term stability of central government expenditure. The financing principles relate to both the expenditure and the income side of the budget.

In work on the budget, the main principle for central government expenditure is that expenditure increases have to be financed by

expenditure reductions. It follows from this that permanent expenditure increases have to be financed by permanent expenditure reductions. So, temporary savings cannot be used to finance more permanent expenditure increases. An income reduction has to be financed by an equivalent reduction of an expenditure or an equivalent increase of a tax, contribution or charge. In addition, the financing of a reform has to be traceable to a proposed regulatory change or another specific measure. 'Dynamic effects' that may arise should not be used for financing. However, an analysis of dynamic effects should be included in the input for the decision.

Income from sales of state-owned assets, dividends or capital reimbursements are reported under income headings, which means that they are not earmarked for certain purposes in specific areas of activities.

4.3 Budgeting and accounting principles

The Budget Act contains provisions on the scope of the central government budget. In accordance with the completeness principle, the Government's proposed budget has to include all income and expenditure, as well as other payments that affect the central government borrowing requirement (Chapter 3, Section 3). In addition, central government income and expenditure have to be budgeted and reported gross in accordance with the gross principle under income headings and appropriations (Chapter 3, Section 4). This means that expenditure has to be reported on the expenditure side of the budget, while income has to be reported on the income side. Exceptions from the gross principle are permitted in cases where the Riksdag has decided that income may be used for a particular purpose in some other way than by a decision on appropriations (earmarking). This income must not be budgeted and booked under income headings. This exception does not apply to tax income. It always has to be budgeted and reported against income headings (Chapter 3, Section 4).

The Budget Act contains a special provision that expenditure may not be budgeted and reported against income headings (Chapter 3, Section 5). This provision is aimed at support that normally has to be financed from appropriations and that has no connection with tax legislation, but is solely reported as credits in tax accounts.

The Budget Act regulates which accounting principles apply to different types of income and expenditure (Chapter 4, Sections 2 and 3). On the income side, income from taxes, contributions and charges has to be reported under an income heading in the budget year to which the revenue refers, which means that taxes, contributions and charges have to be reported in the relevant tax year. Other income has to be reported under an income heading for the budget year to which they refer, i.e. the charging or invoicing date. On the expenditure side, expenditure on transfers has to be reported in the budget year in which payment is made, administrative expenditure in the budget year to which the costs are attributable and other expenditure in the budget year to which they refer, in practice the year when an invoiced or equivalent demand is presented. The cash-based

Skr. 2017/18:207 accounting principle for transfers is applied generally so that a transfer is paid in the year to which the support refers. In exceptional circumstances, departures may have to be made from this principle. Such departures have to be justified by the Government.

4.4 Reporting of tax expenditure

The Budget Act requires the Government to give an account of tax expenditure to the Riksdag each year (Chapter 10, Section 4). Tax expenditure refers to the effect on tax revenue of special rules in tax legislation. This account has to be given in a separate communication. The reporting of tax expenditure serves two purposes. First, this reporting has to make clear the indirect support to households and businesses on the income side of the budget that can partly or wholly have the same function as support on the expenditure side of the budget. Second, it contributes to describing the degree of uniformity of tax regulations.

5 Surplus target

The Budget Act requires the Government to propose a target for general government net lending (Chapter 2, Section 1). Twice in the budget year the Government also has to make a report to the Riksdag on how well the target is being achieved and how a return is to be made the target in the event of an expected deviation (Chapter 2, Section 1 a).

The Riksdag has determined that as of 2019 the level of the general government net lending will be an average of 0.33 per cent of GDP over an economic cycle. Originally the target was 2 per cent of GDP. After Eurostat decided that, as of 2007, savings in the premium pension system could no longer be included in net lending, a technical downward adjustment was made to the surplus target from 2 to 1 per cent of GDP (Govt Bill 2006/07:100, Committee Report 2006/07:FiU20, Riksdag Comm. 2006/07 220 and Govt Bill 2009/10:100, Committee Report 2009/10:FiU20, Riksdag Comm. 2009/10:387). In 2017 the target was changed to 0.33 per cent of GDP (Govt Bill 2016/17:100, Committee Report 2016/17:FiU20 and Govt Bill 2017/18:1, Committee Report 2017/18:FiU1, Riksdag Comm. 2017/18:54). This level of the target for general government net lending, the surplus target, remains in place, but is reviewed every eighth year.

5.1 Reasons for the surplus target

The main reasons for the surplus target are that it is intended to contribute to long-term sustainable public finances; adequate margins so that large deficits can be avoided during economic downturns, even when conducting an active countercyclical policy; an even distribution of resources between generations; and economic efficiency. The surplus

target is formulated in terms of general government net lending as a proportion of GDP. A surplus target that is maintained leads to the stabilisation of the financial position of general government and to fiscal policy being sustainable in the long term. If fiscal policy is not sustainable in the long term, financial markets, households and businesses may lose confidence in the public sector's ability to fulfil its commitments. This may, in turn, lead to situations in which it may be difficult or very expensive for central government to borrow funds.

In addition, in the light of the experience from the financial crisis that began in 2008 there are good grounds for ensuring that the surplus target contributes to there being a buffer so that sharp economic downturns can be countered without risking an unsustainable increase in debt. A surplus target of an average of 0.33 per cent of GDP over an economic cycle is judged to be appropriate to provide this buffer. Experience also shows that, during major global downturns and in times of unrest in international financial markets it is often small, open economies with their own currency that are particularly exposed. In such situations, policy draws strength from having room to manoeuvre in fiscal policy, in form of a surplus in line with the surplus target and a low debt ratio. The surplus target can only be used to deal with temporary changes in the size of age groups, but it cannot fully equalise access to resources between generations. So the target cannot be used to handle trend increases in publicly financed costs that may arise on account of a constant increase in life expectancy over time. Nor can the target be used to finance demands for higher quality of publicly financed welfare services in the future.

5.2 Scope of the surplus target

When designing fiscal policy and proposals for the central government budget, the Government has an overall responsibility to take account of net lending in all parts of the general government, i.e. central government, local government and the old age pension system. If a part of the general government was not covered by the surplus target, there would be more risk that sufficient account would not be taken of imbalances between sub-sectors. Even though the old age pension system is financially sustainable in principle, there is a greater risk of a weaker financial development in the public sector if the system is not covered by the surplus target. By covering net lending in the whole of the general government the target is also in line with the restrictions and reporting requirements in the Stability and Growth Pact, making it easier for international organisations to evaluate fiscal policy. The surplus target therefore has to cover net lending in the whole of the general government.

5.3 Principles for assessing deviations from the surplus target

It is important to have clear principles for monitoring the surplus target and defining deviations. The assessment of net lending in Government

forecasts relative to the surplus target is important supporting information in setting the direction of fiscal policy. It is on this basis that the size of any fiscal space or the need for budget reinforcements is established. The surplus target is also monitored in a backward-looking perspective to avoid the occurrence of systematic errors in fiscal policy that risk reducing the probability of achieving the target in the future.

The surplus target is formulated as an average over an economic cycle instead of as an annual requirement of 0.33 per cent of GDP for stabilisation policy reasons. If the target was that net lending had to correspond to 0.33 per cent of GDP in every single year, fiscal policy would have to be tightened when economic activity slackens so as to achieve the target, resulting in lower tax revenue. Policy would then amplify cyclical fluctuations, since the automatic stabilisers would not be allowed to operate freely. So the formulation of the target as an average over an economic cycle is necessary, but makes it more difficult at the same time to assess whether fiscal policy is consistent with the target since it is then necessary to assess the effect of the current economic situation on net lending.

If economic activity is higher than normal, an assessment based on actual net lending will overestimate the fiscal space or underestimate the need for savings since net lending would have been lower with normal resource utilisation. Such an assessment increases the risk that temporary high surpluses in good years for the economy will be used to finance permanently higher expenditure or lower taxes. Similarly, average net lending would be too high if expenditure and tax rates were set so as to also meet the net lending target in years of distinctly low economic activity. This means that the economic situation must be taken into account when assessing the relationship between the current level of net lending and the surplus target and when determining the size of a fiscal space or the need for budget reinforcement. However, the economic situation cannot be measured unequivocally since there is no single method of measurement that provides a precise measure of it, and therefore of achievement of the target. Despite the uncertainty in the assessment of how the economic situation and other temporary effects impact on general government net lending, the Government takes the view that the structural balance², calculated by established methods, is best suited for assessing whether the current level of net lending and fiscal policy are consistent with the surplus target.

5.4 Ongoing monitoring of the surplus target

The Government is responsible for the ongoing monitoring of the surplus target. The purpose of this monitoring is to assess the size of the fiscal

² The structural balance is a calculation of what the size of general government net lending would be if GDP corresponded to its potential level so that income and expenditure in the sector were not affected by the economic situation or one-time effects. The structural balance is not part of official statistics and can be measured in several ways. The means that different analysts can make different assessments of the level of the structural balance and that there is no generally accepted outcome.

policy measures necessary to achieve the surplus target on the basis of the Government's current forecasts. Additional to this, there is also external monitoring in which the Swedish Fiscal Policy Council has an important role (see section 9).

There is judged to be a deviation from the surplus target if the structural balance deviates clearly from the target level in the present year or the coming year, i.e. the budget year. The Budget Act requires the Government to make a report on how a return can be made to the target if a deviation has been established (Chapter 2, Section 1 a). There may be several reasons for a deviation from the target and it should not be equated with policy being wrongly designed or there being a breach of the fiscal policy framework. There can, for instance, be stabilisation policy reasons that justify conducting an active fiscal policy that weakens the structural balance. But in the event of a deviation the Government has to explain the justification for the deviation and how the Government intends to return to the target.

A backward-looking eight-year average of actual net lending is used to evaluate *ex post* whether the surplus target has been achieved and to detect systematic deviations. Accumulated deviations in net lending that lead to undesired levels of debt may also justify an adjustment of the target level for net lending at the next review of the target.

5.5 Principles for dealing with deviations from the surplus target

If the surplus target is to function as a benchmark for fiscal policy, it is important to correct any deviations. There are a number of principles that the Government applies for determining when and how to deal with deviations from the target. They are linked to the size of the deviations and the economic situation. The principles for how the Government handles the potential conflict between the surplus target and the objective that fiscal policy should not be procyclical are described below. However, it should be stressed that, in practice, the design of fiscal policy is often complicated because other considerations must be taken into account alongside the need for economic stability.

Since forecasts of general government net lending are uncertain, it is not reasonable for small target deviations to lead to policy realignments. That would give policy an undesirable stop-go element. If, however, the deviation is expected to increase substantially after the budget year, this can lead to measures, even though the deviation during the budget year is small. Minor deviations from the surplus target are not a problem as such, provided that the deviations do not tend to move systematically in the same direction. Nor may the uncertainty be used systematically to create space for unfinanced reforms.

The Budget Act requires the Government to report a plan for a return to the target in the event of an expected deviation (Chapter 2, Section 1 a). This plan should be timed and should normally begin during the budget year, usually through proposals in the budget bill for the coming year. In practice, it is the annual decision on the budget for the coming year that

determines how the Riksdag and the Government are living up to the surplus target. If a deviation cannot be recovered in the next budget year, the Government's plan should contain a clear political undertaking for the structural balance in the budget year and succeeding years. Such an undertaking should normally be framed so that the target level of net lending is achieved when the economy is in balance. If the structural balance falls under the target level in a deep recession on account, for instance, of an active fiscal policy, the structural balance should be above the target level when the economy is above resource utilisation in balance so that average net lending does not fall below the target level. In a normal economic situation,³ a target deviation should, as a rule of thumb, decrease at the same rate as is usual in the absence of active political decisions, but resource utilisation has to be taken into account (see table 1).

In assessing when to correct deviations, it is important to take account of the economic cycle. To minimise the risk of fiscal policy being procyclical, general government net lending that is judged to be permanently above (below) the surplus target should not be dealt with until the next economic downturn (economic upturn). However, this principle needs to be elaborated. If, for example, general government net lending is judged to be permanently above the surplus target and an economic downturn is not expected in the near future, it is possible to gradually reduce net lending. It must then be ensured that the effects on demand are not greater than can be dealt with by monetary policy. The size of the measures that may be considered depends on the current economic situation, by how much net lending is expected to exceed the surplus target, how the reforms are expected to affect demand and what the time profile of the effects is like. A further consideration to take into account is whether the intended measure is structurally correct, i.e. to what extent it can be expected to improve the functioning of the economy. Table 1 summarises different action alternatives that may be relevant in dealing with a deviation from the surplus target.

³ A normal economic situation is defined as a GDP gap of between 1.5 and –1.5 per cent of potential GDP.

Table 1 Economic cycle considerations when dealing with target deviations

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	Structural balance above target	Structural balance below target
Good times/high resource utilization	Balance-weakening measures when resource utilisation decreases	Balance-reinforcing measures at rapid rate
Normal times/normal resource utilisation ¹	Balance-weakening measures at moderate rate	Balance-reinforcing measures at moderate rate
Bad times/low resource utilization	Balance-weakening measures at rapid rate	Balance-reinforcing measures when resource utilisation increases

¹ GDP gap between 1.5 and –1.5 per cent of potential GDP

5.6 Regular review of the surplus target

A surplus target for general government finances has to be stable for long periods of time. But it should be possible to review the target on account, for instance, of changes in assessments of demography or debt growth. This also applies to the level of the debt anchor (see section 6).

To avoid revisions of the target level being made in a way that reduces the credibility of the target, it is important to carry them out in a predictable way. Broad political support should also be sought for any changes. The prospects of an orderly review of the target improve if reviews take account of the electoral terms. Once adopted, a surplus target therefore remains in place, but is reviewed every eighth year. These reviews should be conducted towards the end of every second electoral term so that a revised target is able to enter into force in the first year after an ordinary election.

6 Debt anchor

A debt anchor has been introduced to further reinforce the framework and highlight the fundamental importance of the debt for fiscal policy sustainability. It will be in force as of budget year 2019 (Govt Bill 2016/17:100, Committee Report 2016/17:FiU20, Riksdag Comm. 2016/17 349 and Govt Bill 2017/18:1, Committee Report 2017/18:FiU1, Riksdag Comm. 2017/18:54). This means that the debt anchor will be applied for the first time in the 2018 Spring Fiscal Policy Bill, which is the basis for budget work for 2019. The debt anchor has been adopted as a benchmark for the general government consolidated gross debt, the ‘Maastricht debt’ in the medium term. The level of the debt anchor has been set at 35 per cent of GDP. This provides a good margin to the highest level of debt permitted under the Stability and Growth Pact and the critical limits for the debt identified in several international studies. It

6.1 Reasons for the debt anchor

The present fiscal policy framework evolved as a result of the severe situation for central government finances in the early 1990s. The previous general guidelines for economic policy were replaced at that time by clear objectives and restrictions for fiscal policy. Initially their purpose was to stabilise the development of the central government debt by means of annual savings targets. When this had been achieved, a target was introduced for average general government net lending over an economic cycle in order to strengthen the net financial position of the public sector. The general government net debt of around 30 per cent of GDP at the end of the 1990s has since become net financial wealth of just over 20 per cent of GDP in 2016.

The fundamental purpose of the surplus target of establishing sustainability and room for manoeuvre in stabilisation policy is essentially linked to debt and wealth levels rather than to net lending at a particular point in time. In particular, the level of general government gross debt is a key factor in assessing a country's creditworthiness and the scope for active fiscal policy for stabilisation over the economic cycle. Even though the surplus target is more suitable as an operational target in the budgetary process, the size of the debt and net financial wealth play a central role in the decision about the size of the surplus target. So they need to be taken into account in the regular reviews. As a member of the EU, Sweden is also bound by the EU debt criterion, which states that general government consolidated gross debt must not exceed 60 per cent of GDP (see section 9.3).

6.2 Principles for dealing with deviations from the debt anchor

In the spring fiscal policy bill the Government has to report each year on the development of the consolidated gross debt. If this debt deviates from the debt anchor by more than 5 per cent of GDP, according to the outcome of the national accounts for the previous year or according to the forecasts for the present year or the budget year in the spring fiscal policy bill, the Government has to present a communication to the Riksdag at the same time as the spring fiscal policy bill is presented. In that communication the Government has to give an account of the cause of the deviation and how the Government intends to handle it. A communication of that kind will be processed by the Committee on Finance, which can decide to hold a public hearing of the Minister of Finance about the debt situation.

The Expenditure ceiling for central government was introduced in 1997. The Budget Act requires the Government to propose a level of the expenditure ceiling for the third year ahead in the budget bill. The ceiling is set by the Riksdag. If there is a risk that an approved expenditure ceiling will be exceeded, the Budget Act requires the Government to take measures that are within its powers or propose necessary measures to the Riksdag so as to avoid the ceiling being exceeded (Chapter 2, Section 4).

The expenditure ceiling's coverage is not regulated in law. In principle, however, all the ceilings to date have had the same coverage. The established practice is for the ceiling to apply to expenditure areas 1–25 and 27 plus the off-budget expenditure in the old-age pension system. However, the ceiling does not include expenditure area 26 Central Government Debt Interest, etc. Together with local government expenditure, the items covered by the ceiling comprise virtually all general government expenditure. The expenditure ceiling is set in nominal terms, which makes for simple and transparent monitoring. Moreover, an expenditure ceiling set in nominal terms contributes to central government not driving up inflation in situations with a high rate of price and wage increases.

It has become practice that the level of the expenditure ceiling is not altered. The ceiling's cap on central government expenditure has to be unchanged from when the ceiling for a new year has been set until that year has ended.

There are no formal obstacles to the Riksdag deciding to alter a level that has already been set for the expenditure ceiling. If there were, a new government's possibility of making changes to fiscal policy would be greatly restricted; and nor could fiscal policy be adapted to new and completely different external circumstances. However, the ceiling has only been altered on a few occasions as a result of changes in the direction of fiscal policy. This happened, for example, after the changes of government in autumn 2006 and 2014, when the levels previously set for the expenditure ceiling were lowered and raised respectively. In addition, it is now practice to amend levels previously set for the expenditure ceiling in connection with technical budget rearrangements, known as 'technical adjustments', so that the expenditure ceiling retains its original stringency (see section 7.2).

The central government budget process is characterised by a clear medium-term, top-down perspective (see also section 4). The expenditure ceiling is the overall restriction on the budget process in terms of total expenditure, while there is no corresponding restriction for income. The need to set priorities between different expenditures is underlined from when the ceiling is set for the third year ahead, until that year has passed. The medium-term perspective reduces the risk of temporarily high income (on account, for instance, of a good economic situation) being used to finance permanently higher expenditure. This limits the risk of a procyclical fiscal policy on the expenditure side of the budget.

The expenditure ceiling for central government is a core commitment of fiscal policy that promotes budget discipline and strengthens the

credibility of economic policy. One important purpose of the expenditure ceiling is to create conditions for achieving the surplus target, i.e. to create conditions for a long-term sustainable fiscal policy. The level of the expenditure ceiling is also intended to promote a desirable long-term development of central government expenditure. Along with the surplus target, the expenditure ceiling governs the level of the total tax take and helps to prevent a situation in which the tax take must be increased gradually on account of insufficient control of expenditure.

7.1 Level of the expenditure ceiling

The decision on the level of the expenditure ceiling makes clear the complicated relationship between, on the one hand, the Government's possibility of pursuing, with the Riksdag's support, the policy for which it has been given a mandate and, on the other, the need for fiscal policy rules that are intended to make it easier for the political process to take account of the long-term effects of the policy pursued on the public finances.

The level of the expenditure ceiling is an expression of the Government's view of how the public commitment should develop. The composition of expenditure reflects the ideological values on which policy is based, as do the aggregate turnover of the central government sector and the tax take that this requires. It is therefore reasonable that the decision on the level of the ceiling is made by the Riksdag. At the same time, the fundamental idea behind the expenditure ceiling is very much to separate the discussion about the space available for central government expenditure from the discussion of which expenditure is necessary or desirable. A meaningful limit to expenditure has to start in one way or another from a general conception of how the public sector should relate to total production in the country. In the long run the level of the expenditure ceiling determines the total tax take, so its level should be in line with the view of how large a reasonable tax take can be.

The deliberations behind the Government's proposed level of the expenditure ceiling for a new year are justified on the basis of how the ceiling relates to other macroeconomic entities, such as GDP. A description is also given of how the expenditure ceiling can be applied to achieve the surplus target and an acceptable level of the total tax take. It is now practice to consider the following factors when drafting proposals for new levels of the expenditure ceiling:

- the expenditure ceiling in relation to the surplus target;
- the development of the expenditure ceiling and total general government expenditure in relation to GDP;
- the development of expenditure capped by the ceiling and the size of the budgeting margin over time; and
- the development of capped expenditure at constant prices

7.2 Technical adjustments of the expenditure ceiling

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Each decision on the level of the expenditure ceiling for a new year means that the ceiling is defined in a certain way in relation to capped expenditure. This applies both to which expenditure is covered by the ceiling and to how this expenditure is reported in the central government budget. Once the ceiling for the third year ahead has been set, the ceiling's limiting effect on central government expenditure has to be the same for that specific year.

However, over a period as long as three years various budgetary changes normally occur that alter the level of the capped expenditure without a corresponding change in the overall public sector commitment. Conversely, changes can be made that affect the public commitment but that for technical reasons do not affect capped expenditure, for example decisions on legislation enabling the crediting of tax accounts. To maintain the expenditure ceiling's original financial stringency and to keep the ceiling in line with the surplus target throughout the period, adopted levels of the expenditure ceiling must therefore be adjusted so as to neutralise budgetary changes of this kind.

The purpose of technical adjustments is that the expenditure ceiling's limiting effect on public expenditure after a particular adjustment will be as stringent as before the changes that occasioned that adjustment. To result in a technical adjustment of the expenditure ceiling, the change that occasions the adjustment must not have the same net effect on consolidated general government expenditure or on general government net lending as it has on the capped expenditure. Technical adjustments to the expenditure ceiling have been made on several occasions since the ceiling was introduced in 1997 (see, for example, Govt Bill 2010/11:1, Committee Report 2010/11:FiU1, Riksdag Comm. 2010/11:64). The Government bases its proposals for technical adjustments on a number of principles:

- In the case of technical budgetary rearrangements that do not affect the public commitment (e.g., switching from gross to net accounting or vice versa), technical adjustments are made to the levels set for the expenditure ceiling. This applies irrespective of whether the net accounting occurs on the budget's expenditure side (e.g. through earmarked use of charges) or on the income side (e.g. crediting expenditure to a taxpayer's tax account).
- Technical adjustments are made irrespective of whether they raise or lower the expenditure ceiling.
- In the case of changes that affect the public commitment, but not capped expenditure (e.g., a reform with new expenditure that is credited to a taxpayer's tax account) technical adjustments are carried out.

7.3 Size of the budgeting margin

The gap between the expenditure ceiling and expenditure capped by the ceiling is termed the budgeting margin. This margin is primarily intended to act as a buffer if expenditure does not grow as expected on account of the development of the economy. The Government's guideline is that the budgeting margin should be at least 1 per cent of capped expenditure in the current budget year, at least 1.5 per cent for following year, at least 2 per cent for year thereafter, and at least 3 per cent for the third year ahead.⁴ At the same time, there are reasons why the margin for the third year ahead should not to be so large that the expenditure ceiling does not have reasonable steering effect on expenditure growth.

The expenditure ceiling should not be viewed as an expenditure target. However, as the need for a safety margin decreases over time, the budgeting margin can gradually be used for reforms and other expenditure that are not a consequence of the economic cycle. This presupposes that the changes in expenditure are compatible with the surplus target.

8 Local government balanced budget requirement

To strengthen the budget process at local level, a balanced budget requirement for the local government sector has been applied since 2000. The balanced budget requirement is regulated in the Local Government Act and states that every municipality and county council has to budget so that revenue exceeds costs (Chapter 11, Section 5). If there are extraordinary reasons, a local authority may budget for temporary deficits. Examples of such reasons include a strong financial position or the local authority taking measures during the budget year that involve costs but that promote cost savings and sound financial management in the long term. The assessment of what are extraordinary reasons must be made from case to case. If a local authority subsequently shows a year-end deficit, the main rule is that the deviation must be remedied within three years (Chapter 11, Section 12). The municipal or county council assembly is allowed to decide not to adjust negative net income in the case of restructuring of the municipality's or county council's activities intended to achieve lower costs or if there are other extraordinary reasons (Chapter 11, Section 13).

⁴ The guideline for the size of the budgeting margin for the third year ahead, the year for which a new expenditure ceiling is set, is in line with the assessments made in the government inquiry reports Evaluation and further development of the budget process [*Utvärdering och vidareutveckling av budgetprocessen*] (SOU 2000:61) and Stabilisation policy in the currency union [*Stabiliseringspolitik i valutaunionen*] (SOU 2002:16). The Government evaluated the guideline in the 2011 Spring Fiscal Policy Bill. At that time the Government made the assessment that it should not be altered (Govt Bill 2010/11:100 p. 213).

The local government balanced budget requirement is a minimum requirement. Under the Local Government Act municipalities and county councils must also have sound financial management of their activities. The preparatory works give some examples as guidance as to what this means (Govt Bill 1990/91:117 p. 110 and 210 and Govt Bill 2016/17:171 p. 422).

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Normally net income should be at a level that at least consolidates the local authority's finances in real terms. This means that account has to be taken of pension debt and reinvestment needs. As of 2005, local authorities are therefore required to adopt financial targets of importance for sound financial management. One frequent target is that net income that corresponds to 2 per cent of revenue from taxes and general government grants corresponds to sound financial management. Local authorities' annual accounts have to include a statement of whether the balanced budget requirement and the targets for sound financial management have been met.

The local government balanced budget requirement supports the surplus target. Well-managed finances in municipalities and county councils help to achieve the surplus target. The Government therefore follows the development of the local government finances closely and reports on it in the spring fiscal policy bill and the budget bill.

Since local government sector finances are dependent on the economic situation, there is a risk that municipalities and county councils may, by making changes to expenditure and taxes, act in a way that is liable to amplify economic fluctuations. An inquiry was therefore appointed in 2010 with the remit of proposing how to prevent procyclical variations in the activities of municipalities and county councils. As a result of the proposals presented by the inquiry a possibility was introduced in 2013 for municipalities and county councils to reserve part of their surplus in good times, under certain conditions, in order to build up income equalisation reserves (Chapter 11, Section 14 of the Local Government Act). Funds in these income equalisation reserves can then be used to cover deficits that arise as a result of an economic downturn. The intention of the amendment was to create conditions for more stable growth of local government consumption and employment over an economic cycle (Govt Bill 2011/12:172 p. 39).

9 External monitoring

Well-functioning external monitoring of fiscal policy at both international and national level is important for the long-term sustainability of fiscal policy. At international level policy is mainly monitored by various EU bodies, as well as by the OECD and IMF. At international level a number of government agencies are responsible for monitoring.

9.1 Several government agencies monitor fiscal policy at national level

The purpose of the external monitoring of fiscal policy at national level is to ensure that policy is designed in line with existing targets and restrictions. Sweden does not have any sanctions regulated in law that can be used if the fiscal policy framework is not followed. So it is important that political costs are associated with non-compliance with the rules. Increasing the political costs of breaching the framework requires broad support for the applicable regulations, both in the political system and in society, as well as well-functioning external monitoring by several independent bodies.

A number of agencies under the government are responsible for different aspects of fiscal policy monitoring at national level; they include the Fiscal Policy Council, the National Institute of Economic Research and the Swedish National Financial Management Authority. The Swedish National Financial Management Authority and the National Institute of Economic Research make independent assessments of the development of the macroeconomy and public finances and make recommendations about the direction of fiscal policy. The Swedish Fiscal Policy Council has a special responsibility for analysing how well the Government meets the targets of budgetary policy and whether fiscal policy is sustainable in the long term (see section 9.2).

The Swedish National Audit Office is an agency under the Riksdag with the mission of auditing central government activities. The Government has to submit a written communication to the Riksdag, within four months of receiving an audit report from the National Audit Office, that gives an account of the measures the Government has taken or intends to take in response to the report (Chapter 9, Article 19 of the Riksdag Act).

9.2 Role of the Swedish Fiscal Policy Council

The Swedish Fiscal Policy Council has a special responsibility in the monitoring of the fiscal policy framework. With the latest changes to the framework the Council has been given an even stronger role in monitoring the surplus target (Govt Bill 2016/17:100). Under the Ordinance concerning the duties of the Swedish Fiscal Policy Council (2011:446), the Council has the task of making an annual assessment of whether there is a deviation from the surplus target. The Council also has to assess whether a deviation is justified, and at what rate a return to the target should take place. The Council's task is to make a well-founded overall assessment of the relevant circumstances on the basis of the principles for monitoring of the surplus target that the Government and the Riksdag have backed. Following an amendment to the Ordinance concerning its duties, the Council is to place focus more in its analysis than in the past on how fiscal policy relates to the fiscal policy framework. This means that the debate on fiscal policy will focus on general government net lending and the debt. The Council is also to regularly evaluate the Government's

forecasts for the development of the economy and the Government's report to the Riksdag on public finances and the costs of proposed reforms. Skr. 2017/18:207

The Swedish Fiscal Policy Council is to undergo external evaluations at regular intervals. The direction of the evaluations can vary, but an assessment of the Council's review of the fulfilment of the budgetary policy targets in the fiscal policy framework will be a standing feature. In May each year the Riksdag Committee on Finance holds a hearing on account of the Council's report. The emphasis of the hearing, in which the Minister of Finance also participates, is on the fiscal policy framework.

9.3 Monitoring at EU level

As a member of the EU, Sweden has undertaken to follow the rules of the 'Stability and Growth Pact'. The most central rules of the Pact are the permitted reference values of the general government budget deficit (3 per cent of GDP) and general government debt (60 per cent of GDP). If the debt ratio exceeds 60 per cent the distance to this level has to be reduced by 1/20th per year, according to the 'debt criterion'. Countries have to adopt medium-term objectives for their structural net lending, and in the event of deviations from their medium-term objective, they have to move towards this objective by an average of 0.5 per cent of GDP per year, depending both on their level of debt and the development of their economy.

Member Countries also have to respect the 'expenditure benchmark', which broadly means that general government expenditure, including net of discretionary tax measures, in a country should not grow faster than potential GDP. However, Member Countries that exceeded their medium-term budget objective are not bound by the expenditure benchmark.

The Pact also requires Member Countries to present stability and convergence programmes each year that set out how they intend to attain their medium-term budget objective and maintain sound public finances in the medium term. It is also possible to cite specific circumstances that the Commission should take into account in assessing fulfilment of objectives in the preventive arm covering, for example, structural reforms or investments. The Commission then examines the programmes and the Council states an opinion on them. Every euro country submits a draft of their budget for the next year every autumn, which is examined by the Commission. If a Member Country exceeds the reference value for its deficit or does not meet the debt criterion, the Council can decide on the proposal of the Commission launch a special procedure against the country.

To strengthen the monitoring of economic policy in the EU the 'European Semester' was introduced in 2011. The main consequence of the Semester is that fiscal policy (within the Stability and Growth Pact) and structural policy (within Europe 2020) are monitored in parallel. The prime purpose is to strengthen the role of the examination so that recommendations to Member States can be incorporated more easily in their national budget processes while respecting the role and processes of national parliaments.

The Budgetary Framework Directive was adopted in November 2011. This Directive contains minimum rules concerning the characteristics of the budgetary frameworks; one purpose is to ensure that Member States' respect the reference values for the general government budget deficit and the general government debt in accordance with the Treaty on the Functioning of the European Union. The Directive requires Member States to establish medium-term budgetary policy objectives and numerical fiscal policy rules. The targets and rules have to be reflected in the annual budgetary decisions and there have to be consequences in the event of non-compliance. The medium-term budgetary framework has to cover a fiscal planning horizon of at least three years. The frameworks also have to include a description of the impact of planned fiscal measures on general government finances and realistic macroeconomic and budgetary forecasts. These forecasts have to undergo regular and comprehensive evaluation.

As part of the European Semester, the Commission has introduced the 'Macroeconomic Imbalance Procedure', which is an EU procedure for monitoring macroeconomic imbalances in Member Countries. The purpose of the procedure is to detect at an early stage macroeconomic imbalances that can affect macroeconomic stability, and ensure that the imbalances can be prevented. This monitoring is based on a preliminary economic analysis performed by the Commission, including a scoreboard of eleven macroeconomic indicators and three employment indicators that are published in an early warning report.

The Commission also makes long-term projections of general government finances in every Member Country in order to assess whether the country's fiscal policy is sustainable in the long term. The long-term sustainability of fiscal policy is also taken into account in connection with the evaluation of the stability and convergence programmes.

10 Openness and clarity

If the fiscal policy framework is to steer policy and if it is to be possible to monitor fiscal policy, then it is important that the presentation of fiscal policy is transparent and comprehensive. Citizens must be able to gain an insight into fiscal policy. The regulations and principles that govern the presentation of fiscal policy are described below.

10.1 Content of economic bills and communications

Provisions on the spring fiscal policy bill, the budget bill, bills containing amendments to the central government budget and the Government's annual report for central government are set out in the Instrument of Government, the Riksdag Act and the Budget Act. However, the detailed content of the economic bills has evolved through practice.

Provisions on the content of the spring fiscal policy bill are set out in the Riksdag Act and the Budget Act. Supplementary Provision 9.5.2 of the Riksdag Act requires the Government to submit a bill no later than 15 April each year, setting out proposals for guidelines for economic policy and budgetary policy (spring fiscal policy bill). The Act's Supplementary Provision 9.5.3 states that decisions relating to the purposes and activities to be included in an expenditure area are taken in conjunction with decisions relating to the spring fiscal policy bill.

The Riksdag Act does not specify what the guidelines for economic policy or fiscal policy have to contain. The Budget Act states that in the spring fiscal policy bill the Government has to give an account of how the surplus target will be achieved (Chapter 2, Section 1 a), follow up the outcome of the central government budget (Chapter 9, Section 1), present medium-term forecasts of macroeconomic developments and of central government income and expenditure (Chapter 9, Section 3) and present an assessment of the long-term sustainability of public finances (Chapter 9, Section 4). This means that in the spring fiscal policy bill the Government presents its view of the current economic situation, makes forecasts of economic developments 3–4 years into the future, gives an account of the structural, stabilisation and redistribution policy challenges that policy is facing, follows up the budgetary policy targets in the fiscal policy framework and makes an assessment of the current fiscal space or the need for budget reinforcements.

It is practice for the spring fiscal policy bill to contain a preliminary assessment of a suitable level of the expenditure ceiling for the third year ahead, which then normally forms the basis for the proposed level of the expenditure ceiling in the subsequent budget bill (see the section on the budget bill below). It is also practice for the spring fiscal policy bill to contain a separate account of redistribution policy. Within the framework stated, it should be possible to adapt the content of the spring fiscal policy bill to the current political and economic situation.

Budget bill

The basic provisions on the budget bill are set out in the Instrument of Government. It states that the Government presents a budget bill to the Riksdag (Chapter. 9, Article 2). There are also other provisions in the Instrument of Government that are of importance for what the budget bill has to contain. It goes on to state that that the Riksdag adopts the budget for the coming budget year (the budgetary period), and that its decision has to include an estimate of central government income and appropriations for specified purposes (Chapter. 9, Article 3). The Riksdag can decide that central government income may be used for specified purposes in other ways than through decisions on appropriations. The Riksdag can also decide guidelines for central government activities for a period after the coming budgetary period (Chapter. 9, Article 6). Examples of such decisions on guidelines are those on the expenditure ceiling and on the surplus target.

The Riksdag Act contains further provisions on the content of the budget bill (Chapter 9, Article 5). They state that the budget year begins on 1 January and that before that time the Government has to present a bill setting out proposals for central government income and expenditure for the budget year (the budget bill). The budget bill has to include a budget statement and a budget proposal. Unless otherwise decided by the Riksdag, the budget proposal has to include an allocation of appropriations to expenditure areas. It also states that a bill relating to central government income and expenditure for the coming budget year, may only be presented after the budget bill if the Government considers that there are extraordinary economic policy reasons to do (e.g. in economic crisis situations). So the budget bill has to be complete when presented and other bills with separate budget proposals may not normally be presented in the period up to the beginning of the new budget year.

Supplementary Provision 9.5.1 to the Riksdag Act states that the budget bill has to be submitted no later than 20 September. In years in which an election to the Riksdag is held in September, the budget bill has to be presented no later than two weeks after the opening of the Riksdag session. If this is not possible due to a change of government, the budget bill has to be presented within three weeks from the date on which a new government takes office, but no later than 15 November.

The Budget Act states that in the budget bill the Government has to give an account of how the surplus target will be achieved (Chapter 2, Section 1 a), present a proposal for the expenditure ceiling in the third year ahead (Chapter 2, Section 2), present proposals for preliminary income estimates and expenditure limits for the second and third budget year ahead (Chapter 2, Section 3), follow up the outcome of the central government budget (Chapter 9, Section 1) and give an account of medium-term forecasts of macroeconomic developments and of central government income and expenditure (Chapter 9, Section 3). In the budget bill, the Government also has to present an account of the results that have been achieved in activities relative to the targets adopted by the Riksdag (Chapter 10, Section 3).

The Budget Act also contains detailed provisions on the scope of the central government budget as well as on its income headings and appropriations (Chapters 3 & 4). In addition, the Act contains provisions on economic commitments and lending (Chapter 6), financing of investment and lending (Chapter 7) and acquisition and transfer of property (Chapter 8). As a rule, proposals in these areas are submitted in the budget bill or in a bill proposing amendments to the budget (see the section below on amendments to the budget).

The budget bill is mainly arranged in the same way as the spring fiscal policy bill, with the difference that the guidelines for policy in the spring fiscal policy bill are translated into specific proposals chiefly for the coming budget year. Normally the budget bill, unlike the spring fiscal policy bill, does not provide a lengthy account of redistribution policy or an account of the long-term sustainability of public finances. However, the Government usually presents a brief follow-up of the more detailed accounts provided in the spring fiscal policy bill in the same year. In addition, each year an account is given of economic gender equality and, as of 2018, a climate report is presented under Section 4 of the Climate Act (2017:720).

During the budget year the Riksdag may decide on a new estimate of central government income, alter appropriations already made and make new appropriations (Chapter 9, Article 4 of the Instrument of Government). Proposals for such amendments are brought together on two occasions per year in connection with the spring fiscal policy bill and the budget bill. Proposals for amendments may only be submitted on other occasions if the Government finds special grounds for doing so (Chapter 9, Article 6 and Supplementary Provision 9.6.1 of the Riksdag Act).

The budget bill is the basis for the concerted examination of the budget and has to be complete when it is presented. The chief purpose of proposing amendments to the budget is to supplement the budget adopted by the Riksdag on account of changes that could not have been foreseen at the time of the decision. As a general rule, decisions on reforms with lasting budgetary consequences should therefore be taken in conjunction with the Riksdag's consideration of the budget bill in the autumn. Amendments to an adopted budget must be made in an orderly manner and the process for making such changes must be stringent. The requirements made concerning financing, for example, must therefore normally be as strict as in the preparation of proposals for the budget bill. Proposals to increase expenditure should be financed in the first place by reducing expenditure. When proposing amendments to the budget, the Government should analyse and report the effects of the proposal on the budget and the budgetary policy targets. Such a report is not normally presented separately in the proposed amendment to the budget and is, instead, presented in the estimates and forecasts reported by the Government in the spring fiscal policy bill and the budget bill.

Annual report for central government

The Government presents an annual report for central government to the Riksdag after the end of the budget period (Chapter 9, Article 10 of the Instrument of Government). The Budget Act provides that the annual report has to be presented to the Riksdag no later than 15 April in the year after the budget year (Chapter 10, Section 5). The Budget Act also contains detailed provisions on the content and scope of the annual report, basic accounting rules and forms for the presentation of the income statement account, the balance sheet and the cash flow statement (Chapter 10, Sections 6–10).

The content of the annual report has to be aligned with the Riksdag's decision on the Government's budget. An account has to be given of the outcome of the different income headings and appropriations compared with the budgeted amounts. The annual report also has to reflect the other economic decisions made by the Riksdag, e.g., authorisations to order goods and services as well as decisions concerning contributions, benefits and loans that entail expenditure in future years. The annual report also has to inform the Riksdag about expected losses and material risks in guarantees issued and lending (see also the section on risk analyses of central government guarantees and credits below).

The annual report also has to include a follow-up of the budgetary policy objectives adopted by the Riksdag. In addition, the annual report has to include an income statement, a balance sheet and a cash flow statement, a report on the development of central government debt, a unified account of measures the Government has taken in response to observations by the National Audit Office, and a presentation of the EU accounts.

Risk analyses of central government guarantees and credits

As a supplement to the descriptions of central government guarantees and lending operations given in the annual report for central government, the Swedish National Debt Office is commissioned to conduct a comprehensive risk analysis each year. Unlike the follow-up in the annual report for central government, which primarily focuses on the concept of expected loss and the reporting and compilation of individual undertakings, the purpose of the National Debt Office's comprehensive risk analysis is to assess the risk of large unexpected losses.

The comprehensive risk analysis is conducted from two perspectives; both credit risk and liquidity risk are analysed. This risk analysis contributes to stability and confidence in central government finances. In the event of large emerging risks this analysis provides important supporting information for decision-makers, who may need to take action to increase resilience to disturbances or reduce the risks. Parts of the comprehensive risk analysis are also reproduced in the annual report for central government.

10.2 Estimates of effects, forecasts and access to high-quality data

It is important that forecasts and estimates of the effects are made using the best possible methods. The methods and models used for these purposes have to be rooted as far as possible in the current state of research.

Estimates are made of the effects of proposed reforms that can be expected to have considerable macroeconomic consequences. All proposals are analysed, wherever possible, on the basis of their effects on the public finances, GDP, employment and income distribution.

Forecasts are uncertain. In addition to a main scenario, the Government therefore presents a number of alternative scenarios in the spring fiscal policy bill and in the budget bill that reflect both downside and upside risks in economic developments. It is also important that the Government's forecasts are monitored. The Government has therefore tasked the Fiscal Policy Council with evaluating the Government's forecasts. The National Institute of Economic Research also has the commission of producing comparisons each year of different forecasters' forecasts and their accuracy; including the Government's forecasts.

The forecasts presented by the Government in economic bills take account of the proposals presented in the bill concerned. Forecasts are presented for at least three years ahead. A Government assessment of economic developments in Sweden and the public finances is normally

presented in connection with the spring fiscal policy bill and the budget bill. When this is called for by economic developments, the Government also makes public its economic assessment at intervening times. Skr. 2017/18:207

The Government is responsible for the availability of relevant data on the national economy. This is necessary to ensure that forecasts and other types of supporting information for decisions are of good quality. The statistics on the public finances are particularly important. Statistics of high quality are essential for Sweden's ability to live up to the requirements in the Stability and Growth Pact in a credible way. The quality of data produced by Statistics Sweden and other central government agencies has to be as high as possible.

10.3 Long-term sustainability of fiscal policy

Each year the Government has to present an assessment of the long-term sustainability of fiscal policy in the spring fiscal policy bill (Chapter 9, Section 4 of the Budget Act). These assessments are based on estimates that extend so far into the future that the estimates take account of all significant demographic and economic changes that can reasonably be foreseen. The Government makes estimates that cover the development of all general government income and expenditure for the whole of the present century.

Long-term calculations are needed to enable the Government and the Riksdag to take measures at an early stage that make fiscal policy sustainable, even though an unsustainable development will only appear in the long term. The primary purpose of the estimates is to answer the question of whether the current fiscal policy is sustainable in the long term. This is judged to be the case if the tax revenue generated by the present tax rules is sufficient to finance public expenditure that follows from current rules in the long term. The calculations have to take account of the financial position of general government in the year the calculations start from, demographic developments and other relevant trend changes. If the calculations show that the general government budgetary restriction has been met in the long term, the standard of public welfare systems can be retained without needing to raise tax rates.

A measure used by the European Commission to assess the long-term financial sustainability of fiscal policy is the S2 indicator. It gives the size of the permanent budget change required in the starting year to make the net financial position of general government stable as a proportion of GDP in the long term. An S2 indicator value of 1 per cent of GDP means, for example, that an immediate and permanent tax increase or expenditure reduction equivalent to 1 per cent of GDP needs to be implemented in order to balance income and expenditure in the long term.

The uncertainty in assessments of this type is great and they must therefore be interpreted with caution, taking account of how the assessment varies when assumptions are changed. As a result, it is usual to present a number of different scenarios, based on alternative assumptions that show the consequences of both negative and positive risks for the sustainability of fiscal policy. These scenarios are then used

to make an overall assessment of the long-term sustainability of fiscal policy. In view of the uncertainty of the estimates, small indicator values should not lead to any realignment of fiscal policy. If higher indicator values are obtained, the results must be taken more seriously and a more thorough analysis must be carried out. An assessment of the S2 indicator should also include an analysis of what explains the indicator value and how the primary balance has developed over time. If, for example, a high value arises on account of large deficits in the very long term despite a good development of net lending in the coming decades, the assessment of what measures need to be taken should be different from if deficits are expected to arise in the relatively near future.

Even if the S2 indicator shows that fiscal policy is sustainable in the long term, it is not certain that this is correct. An indicator value close to zero does not say anything about the level at which public finances stabilise, only that a stabilisation relative to GDP will take place in the long term. A theoretically long-term sustainable fiscal policy can thus be viewed as unsustainable if debt increases rapidly or stabilises at too high a level or if a deficit in excess of the EU limit of 3 per cent of GDP arises. A long-term sustainable fiscal policy can also be incompatible with a development that is desirable in distributional terms. The indicator can for example, be close to zero if the present generation incurs great debts that are then financed by future generations. That kind of development would lead to injustices between generations. A requirement of higher general government net lending in a calculation in which the number and quality of welfare services provided increases in pace with real income, i.e. a continued increase in quality, can thus be problematic in distributional terms. It can be asked whether increasing general government surpluses today is justified to make it possible to expand the public commitment in the future.

The Government therefore also uses input other than the S2 indicator in connection with the analysis of the long-term sustainability of fiscal policy. For example, it is important to ensure that Maastricht debt does not exceed 60 per cent of GDP, in accordance with the regulations of the Stability and Growth Pact. The debt anchor that has been introduced contributes to ensuring that the general government debt will not exceed this level.

To safeguard inter-generational equity the estimates of sustainability can be supplemented with generational analyses. These show whether there is a systematic redistribution between different generations via the public sector. In cases where a proposal can be expected to have major consequences for the distribution of income between generations, the proposal has to be preceded by generational analyses.

The long-term surveys, undertaken around every third or fourth year (see e.g. SOU 2011:11 and SOU 2015:104) provide additional important supporting information for the design of a sustainable fiscal policy. These surveys analyse challenges and possibilities for the Swedish economy from a perspective of 15–20 years. The long-term surveys are not given any terms of reference and choose the subjects and methods that best contribute to the debate on economic policy. The reports of these surveys serve as supporting information for economic policy. After a consultation has been held on the reports, the Government considers them in the spring fiscal policy bill or the budget bill.

Extract from the minutes of the Government Meeting on 12 April 2018

Present: Prime Minister Löfven, chair, and Ministers Lövin, Wallström, Y Johansson, Baylan, Hallengren, Bucht, Andersson, Bolund, Damberg, Bah Kuhnke, Fridolin, Eriksson, Skog, Ekström, Fritzon, Eneroth

Presenter: Minister Andersson

The Government adopts Government Communication 2017/18:207

The fiscal policy framework consists of a number of principles for the construction of fiscal policy that aim to make fiscal policy sustainable in the long run and also transparent.

