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THE SWEDISH FISCAL POLICY COUNCIL

by

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The Swedish Fiscal Policy Council

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1. Introduction

Changes in fiscal institutions tend to be driven by fiscal problems. The on-going reforms of the European stability pact are one example. So are the changes in national fiscal frameworks occurring or being discussed in many EU countries at the moment. These changes include the strengthening or setting up of independent national fiscal watchdogs, *fiscal councils*, which has recently been endorsed by the European Commission (2010a,b) and EU ministers of finance in the van Rompuy Task Force (2010).

In Sweden there was a radical fiscal reform in the late 1990s. This occurred as a response to a fiscal crisis in the first half of the 1990s of similar proportions as the ongoing crises in, for example, Greece, Ireland, Portugal, Spain and the UK (Figure 1). Sweden got out of its crisis through a tough consolidation programme which turned a fiscal deficit of 11.2 per cent of GDP in 1993 to a surplus of 3.7 per cent in 2000 (see, for example, Henriksson 2007).

Figure 1 General government net lending in Sweden, per cent of GDP

Source: National Institute for Economic Research.

The budget consolidation was followed up by the establishment of a new fiscal framework including four main pillars:[1]

- A *top-down approach* for the central government budget. The Parliament first decides overall expenditures and their allocation among different expenditure areas. Once this is done, it is not possible to increase a particular expenditure without cutting down other expenditures within the same area.
- A *surplus target* for government net lending of one per cent of GDP over a business cycle.
- An *expenditure ceiling* for central government, which is set three years in advance.
- A *balanced budget requirement* for local governments.

The fiscal rules have largely been followed. As a result, government net lending in 2000-2007 was 1.3 per cent of GDP. Hence, it is clear that the establishment of the Fiscal Policy Council (FPC) in 2007 was not triggered by any acute fiscal problems. Instead, it was inspired by theoretical considerations.

The idea of a fiscal council in Sweden was first raised in the discussion on whether the country should join the euro. The issue was – for the foreseeable future – settled in a referendum in 2003, which decided against the euro. Before the referendum, a government commission analysed the requirements on fiscal policy in the event of euro membership. The commission worried that fiscal policy would be too lax in upswings, leaving no room for stimulus in downturns. To counter that risk, the establishment of an independent council, which would give the government recommendations on fiscal policy, was proposed (Swedish Government Commission on Stabilisation Policy in the Event of EMU Membership 2002).[2]

The proposal on a fiscal policy council did not go down well with the Social Democratic government at the time. It was received more positively by the liberal-conservative opposition. The then chief economist of the Moderates (the Swedish Tory

[1] See Budget Bill (2009) or Swedish Fiscal Policy Council (2009) for more detailed accounts of the Swedish fiscal framework.

[2] The commission's proposal had been preceded by earlier proposals by Calmfors (1999, 2001, 2002). The commission was heavily influenced by a background paper by Wyplosz (2002). The commission's proposal on a fiscal policy council was later further developed by Calmfors (2003, 2005).

Party), Anders Borg, endorsed the proposal (Borg 2003). When becoming Minister for Finance after the liberal-conservative election victory in 2006, Borg was the driving force behind the setting-up of the FPC. The council was presented as an important addition to the already existing fiscal framework that would help further safeguard fiscal discipline. Hence, one can see the establishment of the council as resulting from the same determination to avoid fiscal crisis in the future as explained the introduction of the fiscal framework in the late 1990s.[3]

2. The council's remit

According to its instruction (Förordning 2007:760), the Swedish FPC is to:

1. Assess to what extent the government's fiscal objectives are achieved. The objectives include long-run sustainability, the surplus target, the central government expenditure ceiling and that fiscal policy is consistent with the cyclical situation.
2. Evaluate whether economic developments are in line with healthy long-run growth and sustainable high employment.
3. Examine the clarity of the government's Budget Bill and Spring Fiscal Policy Bill with respect to the grounds given for economic policy and the motivations for policy proposals.
4. Monitor and evaluate the quality of the government's economic forecasts as well as the underlying models.

The council is also to "work to achieve an increased public discussion in society of economic policy". The only output formally required is an annual report. To put the activities of the FPC in perspective, they are compared with the fiscal watchdogs of ten other countries in Table 1.[4] A fiscal council is characterised as much by what it does not do as by what it does. Like all other councils in the table, the FPC does both ex-ante and ex-post evaluations of fiscal policy and analyses long-run fiscal sustainability. But there are also tasks that are not performed by the Swedish FPC. Among those are forecasting

[3] See also Calmfors (2010a) for a more detailed discussion of the genesis of the Swedish FPC.
[4] Tasks of fiscal councils in various countries are discussed in more detail in Calmfors (2010b).

(the council only reviews the government's forecasts), costing of individual policy initiatives or detailed budget projections. The main explanation why these tasks have not been included is that they were already performed by other preexisting government bodies (with considerable independence from the government): the National Institute of Economic Research in the case of forecasting and the National Financial Management Authority in the case of detailed budget projections.

The Swedish FPC belongs to the minority of fiscal watchdogs that do not confine themselves to only strictly positive analysis, but who also give normative policy recommendations. The FPC also has quite broad tasks, as it is, in addition to assessing fiscal policy, also to evaluate employment and growth developments. This broad remit may be explained by the fact that employment in 2006 had not returned to the levels that prevailed before the 1990's crisis and that the liberal-conservative parties had made employment their main issue in the 2006 election campaign. The government may also have seen a likely political gain from an expected endorsement by the council of its employment policies, since they include a number of measures recommended by Swedish economists (some of them being appointed members of the FPC).

Something that differentiates the Swedish council from its counterparts elsewhere is that it should also examine the transparency of the government's policy documents and the grounds for policy proposals, that is act also as a kind of "debate watchdog" vis-à-vis the government. This is a task which had not been proposed in the international academic discussion on fiscal councils, so it was an innovation on the part of the Swedish government.[5] A possible explanation could have been a desire to "institutionalise" the strong tradition in Sweden of heavy involvement in the economic policy debate and monitoring of policy proposals and the logic behind them by academics, a tradition threatened today by the strong demands on purely academic publishing within the profession which leaves little time for active participation in the public policy debate.

[5] See Calmfors (2005) or Debrun et al. (2009) for surveys of this discussion.

Table 1 Tasks of fiscal councils

	Forecasting	Costing of policy initiatives	Evaluation of fiscal transparency	Ex-post evaluation of fiscal policy	Ex-ante evaluation of fiscal policy	Complement to fiscal rules	Evaluation of fiscal sustainability	Normative recommen-dations	Analysis of broader issues
Austria (Government Debt Committee 1997)	X			X	X	X	X	X	
Belgium (Public Sector Borrowing Requirement Section of the High Council of Finance 1989)[1)]				X	X	X	X	X	
Canada (Parliamentary Budget Office 2008)	(X)[2)]	X[3)]	X	X	X	X	X		
Denmark (Economic Council 1962)	X			X	X		X	X	X[4)]
Germany (Council of Economic Experts 1963)	(X)[5)]		(X)	(X)[6)]	(X)[6)]	(X)[6)]	(X)[6)]	(X)[7)]	X[6)]
Hungary (Fiscal Council 2008)	X	X	X	X	X	X	X		
Netherlands (Central Planning Bureau 1947)	X	X	X	X	X	X	X		X[8)]
Slovenia (Fiscal Council 2010)	(X)[9)]		X[10)]	X	X	X	X		(X)[11)]
Sweden (Fiscal Policy Council 2007)	(X)[12)]		X	X	X	X	X	X[13)]	X[14)]
UK (Office for Budget Responsibility 2010)	X			X	X	(X)[15)]	X		
US (Congressional Budget Office 1975)	X	X		X	X		X		X[16)]

Notes: The year given in the first column indicates when the institution was first set up. [1)] The Public Sector Borrowing Requirement Section forms part of the High Council of Finance, which was established already in 1936. The council as a whole is chaired by the Minister of Finance, but the Public Sector Borrowing Requirement Section has an independent standing. [2)] Not own forecasts, but analysis of government forecasts. [3)] On request from a parliamentary committee or a parliamentarian. [4)] Analysis of tax, employment and other structural policy as well as environmental policy. [5)] Not own forecasts but description of current economic situation and its foreseeable development. [6)] Fiscal policy is not specifically mentioned in the mandate, which is to assess overall economic developments and to help economic policy makers at all levels as well as the general public to arrive at informed judgements on economic matters. The economic-policy objectives explicitly mentioned in the Council's mandate are stability of the price level, a high rate of employment and equilibrium in foreign trade and payments together with steady and adequate economic growth. The analyses should also focus on distribution of income and wealth. [7)] According to the Council's mandate recommendations of specific policy measures should not be given. But in practice this seems often to de done. [8)] Analysis of a broad range of economic.

issues including tax, employment and regulatory policies as well as resource depletion and financial crises. [9] The Council is not instructed to provide own forecasts but may base its analysis on an independent assessment of economic trends. The council is also to assess the quality of economic forecasts used in the preparation of the national budget. [10] This includes an explicit remit to provide an assessment of the adequacy of set fiscal objectives with the median-term fiscal framework. [11] In addition to other tasks, the Council shall assess the efficiency of implementation of structural policies from the aspect of ensuring long-term sustainability of public finances, economic growth and employment. [12] Not own forecasts but the Council is instructed to evaluate the quality of the government's macroeconomic forecasts and the models on which they are based. [13] The Council's formal remit does not include normative policy recommendations, but the Council itself has established the practice of sometimes giving such recommendations on the basis of the policy objectives formulated by the government and the parliament. [14] In addition to the task of assessing whether the government's fiscal objectives are being achieved, the terms of reference include the tasks of evaluating whether economic developments are in line with healthy long-run growth and sustainable high employment, and of examining the clarity of the government's budget proposals and the grounds given for various policy measures. The council should also work to increase public discussion in society of economic policy. [15] At present there exists no policy rule like the earlier golden rule and the sustainable debt rule, but the government has specified a multi-annual budget consolidation plan. [16] In addition to fiscal and budgetary analysis, the CBO has recently adopted, for example, labour market developments, employment policy and climate policy.

3. The institutional set-up

Formally, the FPC is an agency under the government and the annual report is addressed to the government. The council has no formal relationship to the Parliament, but its Finance Committee organises a public hearing on the basis of the report with participation of the council's chair and the Minister for Finance.

The council has eight members. Six of them are active academics and two are ex-politicians: one former Social Democratic Minister for Finance and one former vice chair of the Moderates (the Swedish Tory Party). There is a small secretariat of four persons. The small size of the secretariat means that the bulk of the work is performed by the council's academic members. This is a problem since the academics perform their work as side activities to their normal academic employment and the work in the council goes far beyond what is a reasonable such side activity.

4. The council's analyses

It is difficult in a short space to survey the council's analyses. But the following has been main themes in the reports.

- The government has been urged to clarify the motives for the choice of one per cent of GDP as the surplus target for net lending. In the FPC's view this requires a more explicit weighting of various higher-level, fundamental fiscal objectives such as social efficiency (tax smoothing), intergenerational equity and precautionary motives (to avoid reaching government debt levels triggering large interest rate rises). The FPC has also criticised the lack of clarity on when the surplus target of one per cent of GDP, which should apply *over a business cycle*, should be regarded as fulfilled and the large number of indicators used in the follow-up which leaves ample room for ambiguous interpretations.
- A recurring theme has been the need for the government to make its long-run fiscal sustainability calculations more transparent, which requires better discussion of basic assumptions, explanations of why calculations differ between years and reporting of alternative scenarios.
- In the recession of 2009, when GDP in Sweden was forecast to fall by more than four percent, there was fundamental disagreement between the FPC and the

government on the appropriate size of fiscal stimulus. The council recommended a stronger *temporary* stimulus (of the order of magnitude of 0.5-1 per cent of GDP in terms of the structural budget balance) than the government had proposed. (According to the government's ex-post calculations in the 2010 Budget Bill there was a structural fiscal surplus in 2009 of 2.1 per cent of GDP and an actual deficit of only 1.2 per cent of GDP.)

- The FPC was critical of the government's attempts to circumvent the expenditure ceiling for 2010 by timing the payment of central government grants to local governments so that they were recorded in 2009 instead when there was more room below the ceiling. The council denounced the use of statistical manipulations and recommended instead the introduction of a transparent *escape clause* (allowing breaches of the expenditure ceiling in deep recessions).
- A key government policy to reduce structural unemployment has been the introduction of an earned income tax credit. The FPC has argued that the earned income tax credit is likely to have a substantial positive effect on employment in the long run, but has criticised the government for not being transparent about how rises in labour supply – due to the credit – are likely to restrain wages and this way create the labour demand necessary for actual employment to increase.
- The government has also reformed both sickness and unemployment insurance, reducing the generosity of these systems. The FPC's view has been that these reforms, too, are likely to raise employment in the long run, but that the implementation has caused unnecessary adjustment problems. A change in the financing of unemployment benefits, raising employee contributions, has led to a mass exodus from unemployment insurance (which is voluntary in Sweden). The tightening of eligibility rules for sickness insurance was overhasty and had to be accompanied by many reversals of the new rules to accommodate unforeseen consequences.

When the FPC takes a stand on the appropriateness of a particular policy, it does so on the basis of the objectives stated by the government. For example, when evaluating the earned income tax credit and the reforms of unemployment insurance, the council's positive evaluation has only concerned that the reforms are likely to help the government reach its stated employment goals. The council does not take a stand on how the employment objective should be traded off against the insurance objective (the objective to limit the income loss from unemployment).

5. The council's impact

Judging from the reactions of the economics profession, media and politicians, the FPC seems to have established itself as an important player in the Swedish economic-policy discussion. The annual report receives a lot of attention in the media when it is published, but it is also frequently quoted and used as a reference in the debate throughout the year. The open hearing on the council's report in the Parliament is broadcast by one of the state television channels. The council's members are frequently asked to comment on both policy proposals and more important economic developments both in Sweden and abroad. Both the IMF and the OECD have made positive evaluations of the council's work and recommended an enhanced role for the council (IMF 2010, OECD 2011). In the international debate on fiscal watchdogs the Swedish council is often advanced as an example (see, for example, Debrun et al. 2009, Lane 2010, Hagemann 2010 and Wren-Lewis 2010).

A well-functioning council should have an ex-ante impact already on the proposals made by the government, both through inducing such proposals and through discouraging others, but this is notoriously difficult to evaluate. One should not expect too much in terms of modifications of proposals already made, since the political cost for governments of ex-post changes may be high. Nevertheless, one could point to at least three cases where the council has been influential.

- The first example concerns the degree of fiscal stimulus in 2009/10 which was gradually increased relative to the government's original plans. It may seem odd that a fiscal council tries to push the government in the direction of more stimulus. But it is not so surprising if one recalls that both the government's cautious fiscal stance and the establishment of the council have the same likely cause: a shift to a culture of fiscal discipline after the traumatic fiscal experiences in the 1990s (see Section 1). If no deficit bias exists in fiscal policy, different cyclical forecasts can, of course, lead a council to the conclusion that the government does not provide enough stimulus in a recession. In addition, a government may feel inhibited to undertake stimulus because this could be wrongly interpreted as reneging on its medium-term fiscal target. Here, an independent council may have more credibility and thus provide "cover" for the government to "do the right thing".[6]

- A second example is the council's call to the political parties in the 2010 parliamentary election campaign to avoid committing to measures that would permanently worsen the budget balance. This advice received widespread media attention and may have strengthened fiscal discipline.
- Finally, the council was likely instrumental in inducing the government to clarify its position on the motives for the fiscal surplus target, its numerical value and how adherence to the target is followed up.[7] The government has also responded to the calls for improving the transparency of the fiscal sustainability calculations.

Somewhat surprisingly the council has had only a small impact in the politically less controversial areas of the transparency of fiscal and employment policy, where the council has asked for better reporting on government investment and real capital assets as well as on active labour market programmes, but where not much has happened.

6. The problems of working in a political environment

The whole idea of a fiscal council is that it should constrain the behaviour of policy makers. It is an expert body designed to give advice based on economic research in a highly political environment. It goes without saying that this may not be without its problems. The experiences of the Swedish FPC can illustrate this.

[6] The argument is similar to the one regarding monetary policy that credibility for an anti-inflationary stance gives the central bank larger scope for monetary stimulus in a downturn (see, for example, Wyplosz 2010).

[7] Clarifications were made in the 2010 Spring Fiscal Policy Bill. They were based on a report by a working group in the Ministry of Finance (Finansdepartementet 2010).

When the council was established in 2007, all three opposition parties – the Social Democrats, the Left Party (the former Communists) and the Greens – voted against in the Parliament. The fear seems to have been that the council would play the political role of providing "scientific" support for the liberal-conservative government. The Left Party expressed its concerns in the following way:

"There is reason to assume that the Fiscal Policy Council will be another body providing false scientific clothing for the government's right-wing policy" (Motion 2006/07:Fi7).

These concerns have not been vindicated. The prevailing view in the press has been that the council has worked in a politically unbiased way. Both the Social Democrats and the Greens seem now to have dropped their opposition to the council. On the other hand, there has been an increasingly critical government attitude to the council. In the parliamentary hearing regarding the first report in 2008, the Minister for Finance, Anders Borg, stated:

"The basic aim of having a fiscal policy council is to add another component to a well-functioning fiscal framework, to improve the possibilities of evaluation and follow-up of the fiscal targets."

and

"This report has already demonstrated that the Fiscal Policy Council has an important function". (Finansutskottets betänkande 2007/08FiU20).

These statements can be compared with the Minister's remarks at a conference in late 2010:

"I have established the earned income tax credit and the Fiscal Policy Council. I am convinced that at least one of the two is very useful. I am very doubtful of the other" (Örn 2010).

To understand the second citation, one should know that the earned income tax credit is the Minister's pet project. The remarks came on top of a series of critical comments about the council's work over several months.

How should one explain this change in attitude? A possible explanation is that, to be useful, the analyses of a government watchdog must focus more on the scope for improvement than on praising the already good. Therefore, the reports are likely to contain substantial parts that are critical of government policies and recommendations on what is seen as better ways of achieving the set goals. Since the political opposition's proposals are not subjected to similar critical evaluations, there may be an impression that the council is more critical of the incumbent government's policies than of the opposition's alternatives, even when the reverse is the case. This tendency may be reinforced by the media logic that it is more interesting news if the council is critical of government policies than if it endorses them.

This problem may become less severe over time, as the public will learn that the council makes critical evaluations of the policies of all governments. One way to deal with the problem already in the short run that has been suggested could be to extend the remit also to evaluations of the opposition's proposals. In the Netherlands, a practice has developed according to which the political parties submit their election platforms to the Central Planning Bureau (CPB) for evaluation (Bos and Teulings 2010). But these evaluations are confined to the budgetary implications of the platforms. Such an extension of the remit would seem less appropriate in the Swedish case where the tasks are broader, involving evaluations also of employment and growth policies as well as evaluations of the transparency of and grounds for policy proposals. Making such broad evaluations of both the government's and the opposition's economic policy proposals would amount very much to acting as a *referee* in the political process at large. This would make it much more difficult to keep clear of political value judgements than when judging the government's policies against well-defined criteria established by the political majority.

7. Seven lessons from the Swedish experiences

I shall end by summarising seven important lessons from the Swedish experiences.

1. To earn credibility for independent evaluations, it is crucial that a fiscal council does not confound evaluation and monitoring with continuous policy advising, especially not advising behind "closed doors". Such advising is likely to lead to

psychological bonds that make impartial evaluation very difficult and would not be consistent with a reputation for objectivity. For this reason, the FPC only communicates its policy judgements to the government in written reports, public announcements and public discussions.

2. A composition of a fiscal council where the majority of members are academics is probably a good thing. According to the Swedish experience, this has been very helpful in keeping out political concerns from the policy evaluations. This is much easier to do if one's main arena is the academic one and one's future career is not likely to be in government administration. There would be a high reputational cost in the academic arena for any researcher who would be seen to act in a political way in a fiscal council rather than delivering only research-based judgements. Having an academic position also means that members can quit the council and go back to full-time academic work without any significant personal sacrifices.[8]
3. Although a composition of academics does promote independence in a *real* sense, it is also helpful with arrangements that also promote independence in a *formal* sense. One appropriate arrangement in the Swedish case is that the government appoints members after proposals from the FPC itself, which are made public. This imposes a reputational cost on the government of not following the council's recommendations and instead making politically motivated appointments. But more could be done, for example along the lines of what applies to central bank executive boards. This could involve longer terms of office, which probably also should be overlapping to ensure only a gradual renewal of the council. For the Swedish FPC, the initial terms of office were three years, but after the first three-year period, new appointments were made for only one year, which has created an undesirable uncertainty. One could also question the appropriateness of having the FPC as an ordinary government agency. This means that at the same time as the council evaluates the

[8] Two of the FPC's eight members are ex-politicians. For this to work it is required that the ex-politicians are really ex and act as such. This has on the whole been the case in Sweden. The presence of the ex-politicians seems to have strengthened the legitimacy of the council and helped avoid the impression that the council's evaluations are academic products not grounded in reality.

government, the council's performance (in critically evaluating the government) is also evaluated by the government according to standard procedures for government agencies. This evaluation forms the basis for budget appropriations. It is obvious that this could take the relationship between the government and the council into an inappropriate grey zone. One way of signalling the independence of the council could be to make it instead an agency under the Parliament, even though it is unclear how much difference this would make, since MPs belonging to the political majority seldom act independently of the government.[9]

4. A fourth conclusion – not an unexpected one from a council chairman – concerns the need for adequate funding from the start. Compared both to its tasks and to its foreign counterparts, the Swedish FPC was clearly underfunded from the beginning, relying instead on the willingness of academic members' ordinary employers (universities and research institutes) to fund their employees' work for the council, which is not a sustainable arrangement. This has meant that the council has been obliged to enter into continuous negotiations with the government on increased resources. Hopefully, the council has had the integrity not to let this affect its judgements, but such a situation is awkward.
5. The FPC does not make own macroeconomic forecasts, but only evaluates the government's forecasts. This is helpful from the point of promoting independence, since making official forecasts – especially if the government budget is to build on them – can increase the risk of political pressures. There are clear evidence of that from the experiences of the CPB in the Netherlands (Bos and Teulings 2010). The risks would seem even greater in the UK, where the Office for Budget Responsibility provides the macroeconomic forecast in the government's budget bill. This makes it impossible to avoid a continuous,

[9] Two examples of this are Canada and Hungary. In Canada, the Parliamentary Budget Office had its budget cut in 2009 after publishing reports critical of the government (Page 2010). The earlier fiscal council in Hungary, an agency under the Parliament, was abolished in 2010 after having criticised the government for overoptimistic budget projections (Calmfors et al. 2010).

behind-closed-doors interaction with the Treasury on numbers, which could easily turn into a negotiation process (Calmfors 2010c).

6. How broad should a fiscal council's remit be? There is probably no general answer. On the one hand, there is a risk that public interest in fiscal issues is crowded out if there are other tasks as well. On the other hand, it might be an advantage for the public debate if analyses of various policy areas are delivered by a body which has managed to acquire a reputation for good analysis and which the public can identify. Another advantage with a broad remit is that it makes it more likely that the council's evaluations of government policy will contain both positive and negative elements, which is helpful for maintaining a reputation for impartial analysis. In the Swedish case, one should note though that the analyses by the council that seem to have annoyed the government the most are those of how policies have been explained and motivated. But this could just as well be taken as an argument in favour of such a "debate watchdog task" – to promote the use of an proper arguments and that citizens are presented with as relevant trade-offs as possible is perhaps the most important contribution that economists can make to economic policy-making.
7. Finally, one should from the onset specify procedures for evaluations of the council's work. This is potentially important for the quality of the work. It is perhaps even more important for the council's legitimacy and for protecting against unfair criticism from the political sphere. To reduce the risk that evaluations are biased, they should probably be carried out by international organisations.

At the moment there is an ongoing discussion in Sweden on the Fiscal Policy Council, initiated by an open letter from the council to the government in late 2010 (Swedish Fiscal Policy Council 2010). The letter pointed to the need for additional funding as well as the desirability of institutional changes strengthening the formal independence of the council. The Minister for Finance has expressed his interest in a multi-party agreement on such institutional changes. This would be very welcome from the point of view of the council. But there appears to be no willingness to increase the council's funding. Rather, the government seems determined to close all possibilities of temporary “buy-outs” of council members from their ordinary employers in order to put a “cap” on the time that can be devoted to council work. This represents a serious threat to the scope and quality of the council’s work.

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