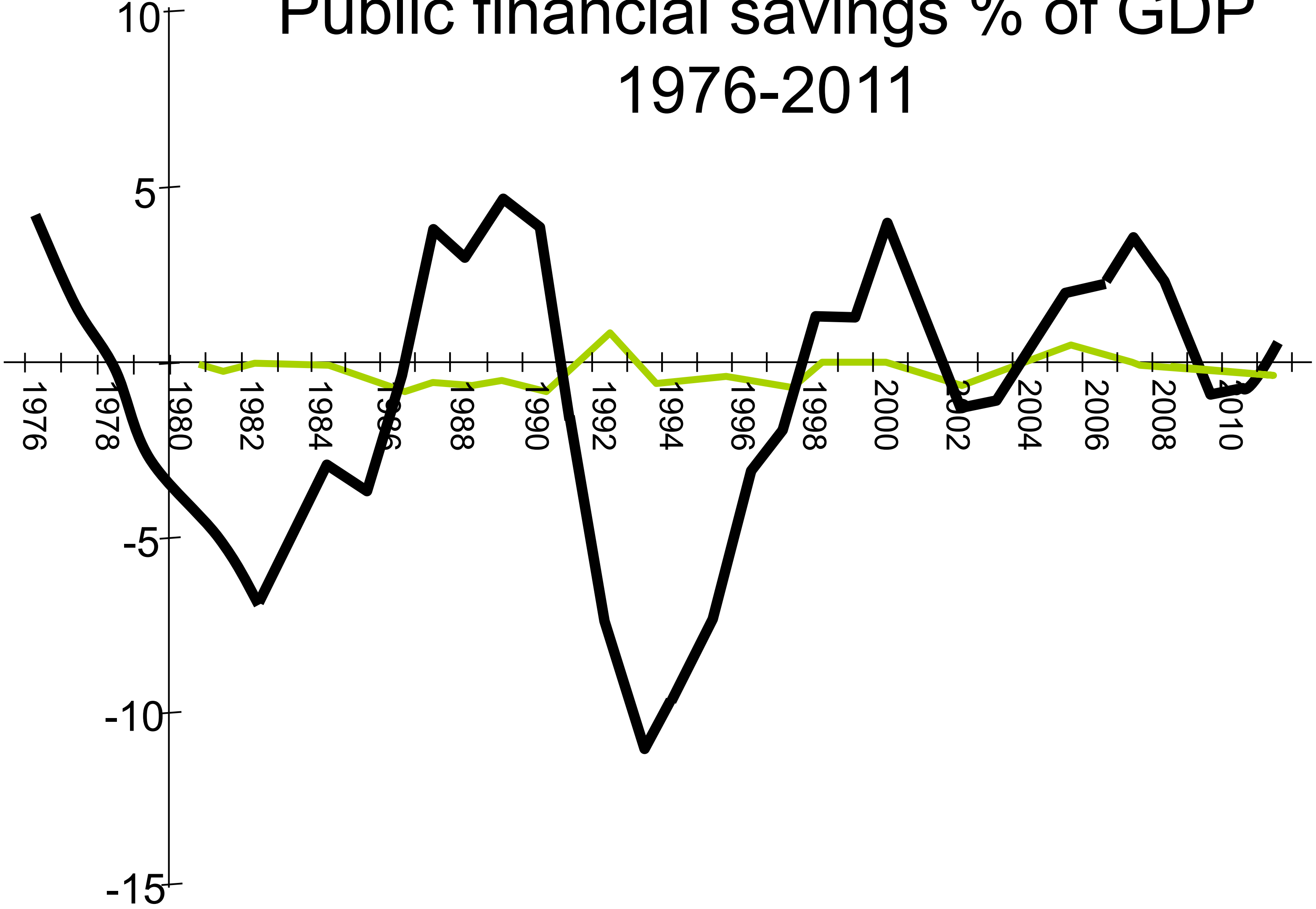
The Swedish Fiscal Policy Framework

Sweden during recent crisis

- Despite a drop of GDP of 7% and a typically high fiscal balance elasticity, Sweden
  - Moderate drop in the fiscal balance.
  - Modest maximum deficit .7%. Now surplus
  - Recovered to pre-crisis GDP in 2010.
- Key explanations:
  - Strong budget before crisis due to well-functioning fiscal framework.
  - No structural imbalances – no domestic amplifications mechanisms.
  - Luck.

Public financial savings % of GDP 1976-2011



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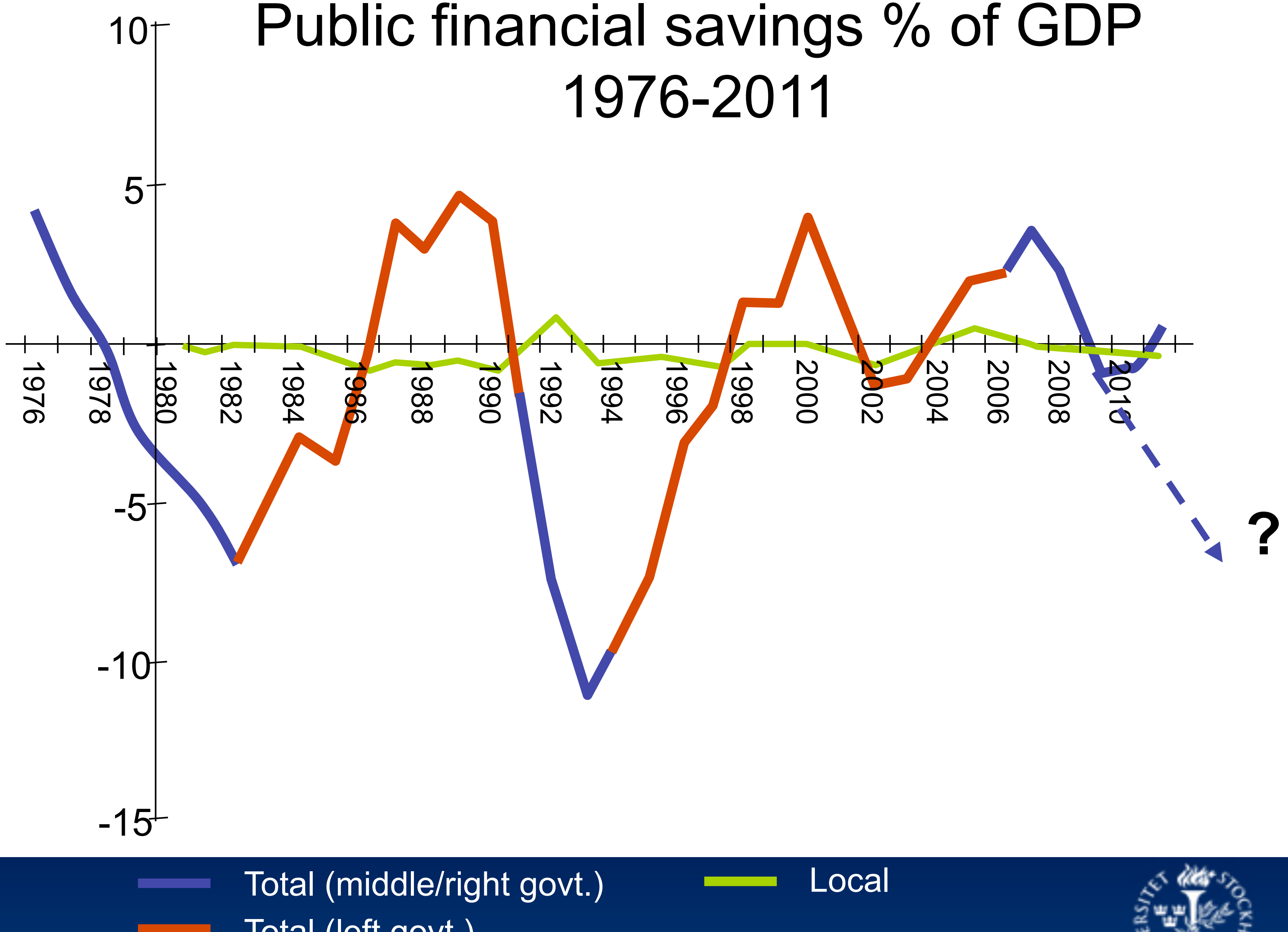

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Key components of Swedish Fiscal Framework

- Top-down approach to budget both in government and parliament.
  - 1. decisions on aggregate spending and income, 2. aggregate decisions on 27 spending areas, 3. detailed decisions. (*against common pool problems*)
- Three-year decisions on nominal spending ceilings including all expenses (excl. interest payments). (*against time inconsistency*)
- Decisions on level of pre-specified budget buffer for unexpected expenses instead of "loose budget items".
- Surplus target of 1% surplus over the business cycle. (*against deficit bias*).
- Balanced budget requirement on local governments.
- Since 2007 a Fiscal Policy Council with a broad remit. (*facilitate transparency and accountability*)

Has it worked?

- Generally successful implementation;
  - Top-down approach is followed.
  - Spending ceilings have not been passed (albeit some minor, and politically costly, creative bookkeeping).
  - Surplus target also met.
  - Broad political support. Opposition wanted more spending during crisis, but less than 1% of GDP.
  - Some recent heated controversies between finance minister and FPC, but with the latter proposing *higher* spending.

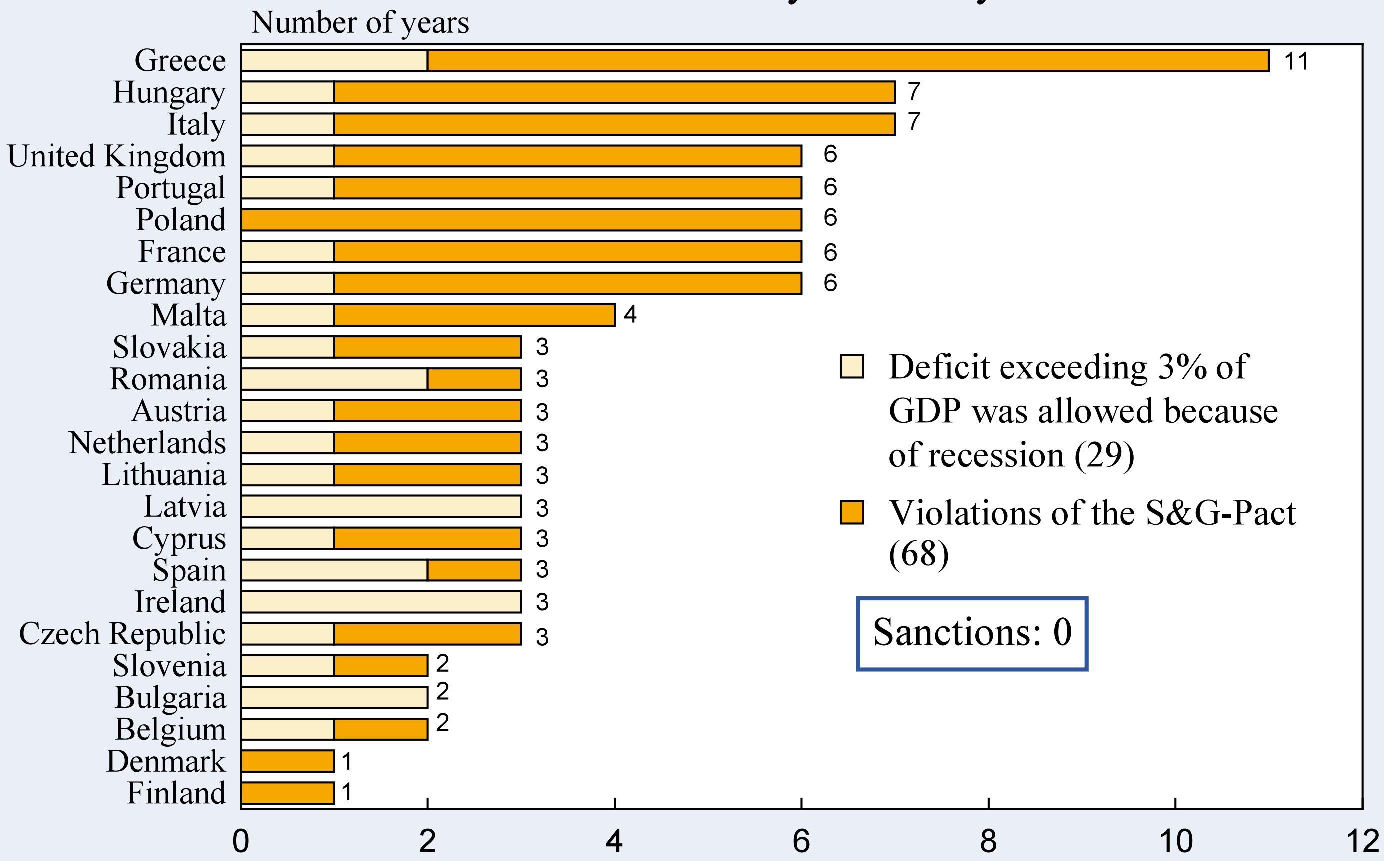
Lessons from Sweden

- **Mandate for change**
  – A broad political *and* popular support for fiscal reform is a necessary precondition.
  – Requires wide understanding of intertemporal budget constraint.
  – “Someone” else is not going to pay. Crisis can be a trigger.
- **Institutional change** works both by
  – **cementing** – increasing institutional memory of consequences of unsound fiscal policy. Building reputational costs of deviations.
  – **facilitating** – top-down approach in budgeting. FPC increases transparency facilitates accountability.
- **All reasons** for deficit bias need to be identified and addressed.
  – Common pool, information, time consistency.

Violations of G&S Pact

Member states with excessive deficits

since 1999 or from year of entry



Without excessive deficit: Sweden, Luxembourg and Estonia.