

**Institute for International Economic Studies**  
**Seminar paper No. 764**  
**THE SWEDISH FISCAL POLICY COUNCIL –**  
**Experiences and Lessons**  
**by**  
**Lars Calmfors**



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# **The Swedish Fiscal Policy Council – Experiences and Lessons**

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### **Abstract**

The Swedish Fiscal Policy Council, established in 2007, has small resources but a broad remit. In addition to monitoring the long-run sustainability of fiscal policy, the council evaluates the short-run fiscal stance from a cyclical perspective. The council also analyses long-run employment and growth developments. Another task is to evaluate the motives, explanations and research basis for government policies. There is no unique best set-up of a fiscal policy council. Instead, it has to be adapted to the special characteristics of each country. The set-up of the Swedish council appears consistent both with the pre-existing institutional framework, with also other bodies making detailed budget evaluations and macroeconomic forecasts, and with a strong tradition of academic participation in the policy debate. The broad remit could lead to less focus on the fiscal watchdog role. On the other hand, the council plays a “supervisory” role in the general economic policy debate, helping to raise the standards of the discussion, which is a fundamental democratic objective.

## 1 Introduction

Over the last decade or so, a number of proposals on the establishment of independent fiscal policy councils have been advanced.<sup>1</sup> The underlying motive has been to find ways of transferring the positive experiences from independent central banking to the fiscal sphere. The proposed tasks for such councils have varied: making actual fiscal policy decisions, giving policy recommendations to the government and monitoring its policy *ex ante*, monitoring government policy *ex post* and providing independent forecasts for the government to base its budget bills on.

One example of an existing body of this type is the *Swedish Fiscal Policy Council*, which was established in 2007. This paper describes the set-up of the Swedish council and analyses the experiences from its work.

The paper is structured as follows. Section 2 gives the background for the creation of the Swedish council. Section 3 describes its set-up and remit, whereas Section 4 gives a brief account of its work so far. Section 5 discusses how a number of issues of principles have been handled in the Swedish case and what the Swedish experiences can teach us in these respects. Section 6 concludes.

## 2 Background

To understand how the Swedish Fiscal Policy Council functions, a short historical background is needed.

### 2.1 The fiscal policy framework in Sweden

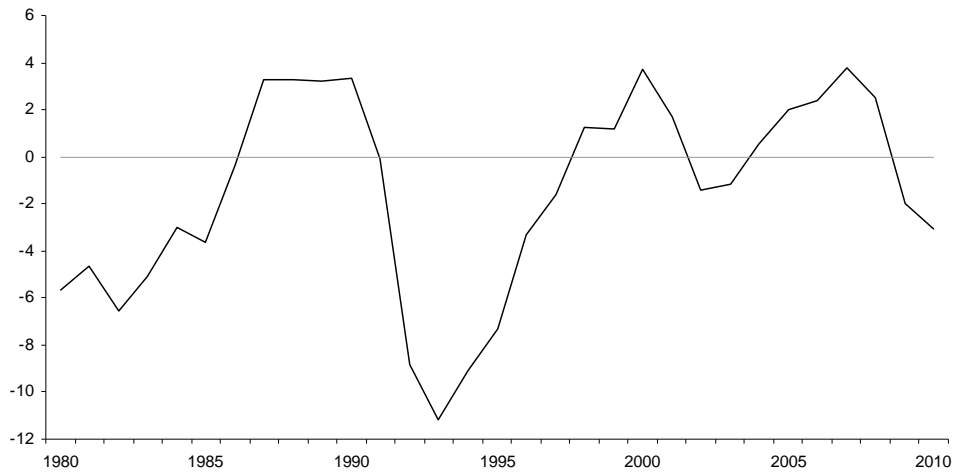
In the early 1990s, the Swedish economy suffered a deep economic crisis, involving massive bank failures, much as the current financial crisis in many countries. GDP fell and unemployment rose dramatically. As can be seen from Figure 1, the crisis had serious repercussions for public finances with a peak budget deficit of 11.2 per cent of GDP in 1993. Figure 2 shows how consolidated public debt rose from 42.3 per cent of GDP in 1990 to 73.0 per cent in 1996. In 1994-95 there were a long-term interest rate

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<sup>1</sup> See, for example, Wyplosz (2002, 2005, 2007), Calmfors (2003a, 2005), Annett et al. (2005), and Jonung and Larch (2006) for surveys of various proposals. Kirsanova et al. (2007) and Wren-Lewis (2009) are recent proposals for the UK.

differentials to Germany of the magnitude of 3-4 percentage points (for ten-year government bonds), as can be seen in Figure 3.<sup>2</sup>

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



*Source:* OECD.

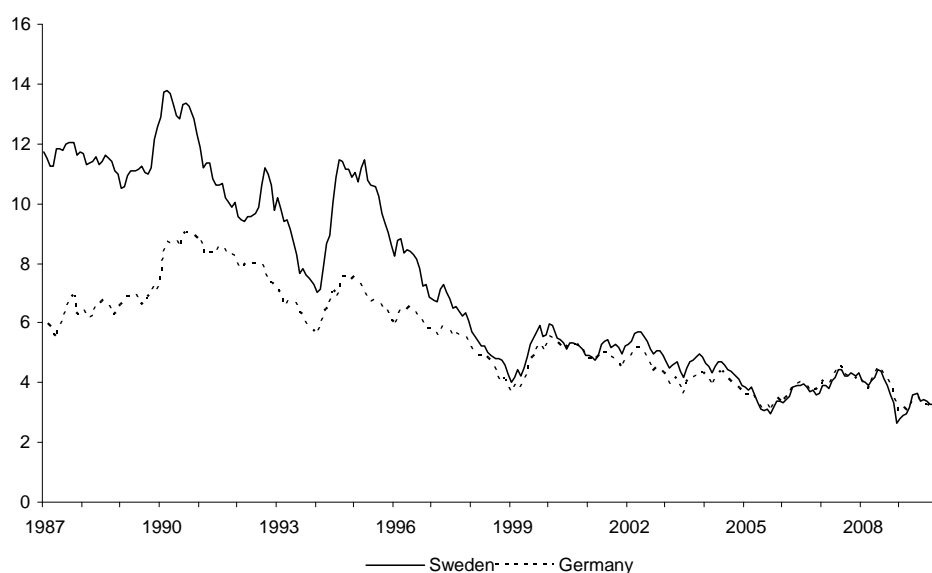
**Figure 2. Gross general government debt in Sweden, per cent of GDP**



*Source:* National Institute for Economic Research.

<sup>2</sup> Interest rate differentials were even larger around 1990. However, this reflected devaluation expectations rather than fiscal sustainability concerns.

**Figure 3. Interest rates on ten-year government bonds in Sweden and Germany**



Source: The Riksbank.

The crisis in public finances triggered determined actions to deal with the situation. An ambitious budget consolidation programme was launched by the new Social Democratic government in 1994. The programme built on clearly defined budget targets setting out an *unconditional* plan for reductions of the deficits that were to be reached independently of cyclical developments. The plan was carried out successfully.<sup>3</sup> In 2000 the budget deficit had been turned into a surplus of 3.7 per cent of GDP.

The crisis also led to the establishment of a new fiscal policy framework to prevent fiscal crises from arising in the future. The framework is still in place. It has four central pillars:<sup>4</sup>

- A *top-down approach* for the central government budget. The parliament first decides overall expenditures as well as their allocation among different expenditure areas. Once this is done, it is not possible to increase a particular

<sup>3</sup> See Henriksson (2007) for an account of the Swedish budget consolidation process.

<sup>4</sup> See, for example, the Budget Bill (2009) for an account of the Swedish fiscal framework.

expenditure without cutting down other expenditures within the same area. The internal government work on its budget proposal follows the same principles.

- A *surplus target* for general government net lending. The target is formulated as a surplus of one per cent of GDP over a business cycle.
- A *ceiling for central government expenditures*, which is determined three years in advance.
- A *balanced budget requirement for local governments*.

The fiscal rules put in place have largely been followed. As a result, government net lending in the period 2000-2008 amounted to 1.6 per cent of GDP. The surpluses in 2007 and 2008 were as large as 3.8 and 2.5 per cent of GDP, respectively. The most problematic rule has been the central government expenditure ceiling. Although it has never been formally violated, it has been circumvented several times through the use of tax expenditures and manipulations of the timing of payments.<sup>5</sup>

## **2.2 The establishment of the Swedish Fiscal Policy Council**

Changes in fiscal policy institutions may occur either as a response to acute problems or as a response to theoretical considerations regarding future potential problems. In the Swedish case, it was the latter type of response behind the establishment of the Fiscal Policy Council.

The idea of a fiscal policy council in Sweden was first raised in connection with the debate on whether or not the country should join the euro. This issue was - at least for the foreseeable future – settled in a referendum in 2003, which decided against the euro. Before the referendum, a government commission was appointed with the remit to analyse how the requirements on fiscal policy would change in the event of Swedish euro membership. The background was the insight that country-specific macroeconomic shocks would have to be handled through fiscal policy only once the country had relinquished its own monetary policy. The commission worried that fiscal policy would be too lax in ordinary times and booms, leaving no room of manoeuvre for stimulus in downturns. To counter that risk, the establishment of an independent fiscal policy

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<sup>5</sup> See the Spring Fiscal Policy Bill (2007) and the Swedish Fiscal Policy Council (2008).



council, which would give the government authoritative recommendations on fiscal policy, was proposed.<sup>6</sup>

The idea of a council did not come down well with the Social Democratic government at the time, which explicitly opposed the idea. The Social Democratic government also criticised later proposals of the same type.<sup>7</sup> However, the idea was received more positively by the liberal-conservative opposition. More specifically, in 2003 the then chief economist of the Moderates (the Swedish Tory Party), Anders Borg, wrote an article on fiscal policy in the – semi-popular – journal of the Swedish Economic Association, where he came out in favour of an advisory fiscal policy council.<sup>8</sup>

In September 2006, the liberal-conservative parties won the parliamentary election and formed a new government with Anders Borg as finance minister. Once in a government position, he might have been expected quickly to forget about his earlier endorsement of an independent council. To his credit he did not. On the contrary, he pushed the idea and a council was established, starting its activities from 1 August 2007. There was, however, disagreement between the political blocs on the council. All opposition parties – the Social Democrats, the Left (the former Communist Party) and the Greens – voted against the establishment of the council. The Left did that with the motivation that “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”.<sup>9</sup>

Empirical studies of fiscal rules and fiscal transparency tend to find that both contribute to stronger budget outcomes. A well-known problem is, however, the difficulty of establishing whether such set-ups *cause* the budget outcomes or whether both they and the budget outcomes are *caused* by the same third factor(s).<sup>10</sup> These considerations are highly relevant for the Swedish Fiscal Policy Council. It is obvious that *both* the strong budget outcomes in recent years *and* the establishment of the council can be seen as consequences of a strong striving to safeguard public finances, which in its turn is explained by the experiences of fiscal crisis in the first half of the 1990s. This does

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<sup>6</sup> Swedish Government Commission on Stabilisation Policy in EMU (2002).

<sup>7</sup> Calmfors (2003a,b), 2005).

<sup>8</sup> Borg (2003).

<sup>9</sup> Motion 2006/07:Fi7.

<sup>10</sup> See, for example, Alt and Dreyer Lassen (2006) and Fabrizio and Mody (2006).

not, of course, imply that the council may not have an additional disciplinary effect on fiscal policy over and above that of the political consensus that one should aim for strong public finances.

### **3 Set-up and remit of the Swedish council**

#### **3.1 The set-up of the council**

The council is formally an agency under the government, which appoints the eight members for a three-year period. At present they are made up of six academic economists and two ex-politicians (a former Social Democratic finance minister and a former vice chair of the Moderates). The members need not be Swedes: currently there are two foreign members: a Danish economist (resident in Denmark), who is vice chair of the council, and a Finnish economist (resident in Sweden).<sup>11</sup> The council is supposed to have an even gender balance (which it has not achieved so far – at present there are six men and two women in the council). The members of the council perform their duties as supplementary activities to their ordinary work (academic positions in most cases). The council is aided by a small secretariat consisting of four persons.

#### **3.2 The remit of the council**

The Swedish council has a much broader remit than according to most proposals on fiscal policy councils. It is not confined to fiscal policy only, but encompasses other economic policy as well. The formal remit is:

1. To assess to which extent the government's fiscal policy objectives are being achieved. These objectives include long-run sustainability, the surplus target, the ceiling on central government expenditure and that fiscal policy is consistent with the cyclical situation of the economy.
2. To evaluate whether economic developments are in line with healthy long-run growth and sustainable high employment.

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<sup>11</sup> The Danish economist is Torben Andersen, a former chair of the Danish Economic Council, and the Finnish one Laura Hartman.

3. To examine the clarity of the government's budget bill and spring fiscal policy bill, in particular with respect to the grounds given for economic policy and the motivations for policy proposals.
4. To monitor and evaluate the quality of the government's economic forecasts as well as the underlying models.

The cited formulations make it clear that an important part of the remit is to try to safeguard a high level of economic policy discussion by monitoring that policies are explained and motivated in a proper way and that they are based on sound analytical foundations. This is also emphasised by the formulation in the statutes of the council that "it should work to achieve an increased public discussion in society of economic policy".<sup>12</sup>

The council's statutes are, however, somewhat vague on to what extent evaluations are to be *ex post* and to what extent *ex ante*. This has been left to the council itself to decide. The interpretation made has been that evaluations should be both *ex post* and *ex ante*. So, the council comments on new government proposals and sometimes makes alternative proposals in addition to evaluating past policies.

The only formal requirement on the council is that it should produce an annual report in May each year, about one month after the government has presented its spring fiscal policy bill (which judges the economic situation and gives guidelines for future policy). The annual report is formally addressed to the government. The council has no formal relationship to the parliament. Its Finance Committee, which prepares the parliament's decisions on fiscal policy, however, organises a public hearing on the basis of the report (one week after its publication) with participation of the council's chair, the finance minister and one or two outside economic experts.

#### **4 The council's work**

So far the council has produced two annual reports (2008 and 2009) and an extra interim report in 2009 on the 2010 Budget Bill. The third annual report will be published in May this year.

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<sup>12</sup> Förordning (2007:760).

#### 4.1 Themes in the reports

A common theme in both the published reports by the council has concerned ambiguities regarding the surplus target of one per cent of GDP. When the target was decided in 1997, no clear justification was given for the level chosen. Later government bills have made it clear that the surplus target should be seen as an *intermediate target* that should help achieving more fundamental objectives: fair intergenerational distribution, social efficiency (tax smoothing), and the build-up of a precautionary buffer to deal with both long-run uncertainties and give room for manoeuvre to use fiscal policy for stabilisation purposes. However, the government has never specified the relative weights of the different underlying motives, which should be necessary to decide the appropriate level of the fiscal target. The council has urged the government to provide better underpinnings for the chosen level and to link it better to long-run sustainability calculations. This would also require the government to take a clearer stand on pension rules, since there is an obvious trade-off between future rises in the retirement age and pre-funding as strategies to cope with demographic pressures.<sup>13</sup>

A related issue where the council has been critical of the fiscal framework concerns the interpretation of the target formulation “a surplus of one per cent of GDP *over a business cycle*”.<sup>14</sup> Here the government has used five different indicators to judge whether this is achieved: a backward-looking average starting from 2000 (the first year the target applied), a forward-looking seven-year moving average centered on the current year, the annual structural budget balance, a backward-looking average of structural balances from 2000 and a forward-looking seven-year moving average of structural balances. The use of a large set of indicators could create confusion, since the indicators may show very different results. More fundamentally, the surplus target has very different implications for policy depending on whether it is interpreted in a backward-looking way “with memory” (thus requiring that one makes up for past deviations from the target) or in a forward-looking way “without memory” (requiring no such compensation for deviations). The council has argued that the target has not really been

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<sup>13</sup> See Finanspolitiska rådet (2008), Sections 1.1, 1.2 and 2.3, and Swedish Fiscal Policy Council (2008), Section 2.

<sup>14</sup> See in particular Swedish Fiscal Policy Council (2009a), Section 2.2.

defined until the metrics for evaluating whether or not it has been achieved have been made clear. So far, this lack of clarity does not seem to have given rise to credibility problems, but there is a potential risk for the future.

The council has also been critical of the government's handling of the expenditure ceiling, where the payment and recording of expenditures have been moved between years so as to achieve a large budget margin below the ceiling in all years.<sup>15</sup> This has been motivated by a desire to not let the ceiling impede stimulus actions on the expenditure side in the current downturn. The council's view is that the introduction of a well-defined *escape clause* is preferable to such less transparent circumventions, which have no obvious limitations to them once they have begun to be used.

The greatest disagreement between the council and the government has concerned the appropriate amount of fiscal stimulus in the current economic crisis.<sup>16</sup> Notably, at the onset of the crisis the council recommended *more* discretionary fiscal stimulus than the government thought appropriate. In the council's view the government was too much led by fears of a repetition of the fiscal crisis in the early 1990s (which was also presided over by a liberal-conservative government) and did not fully appreciate the differences to that crisis: much lower government debt to start with, more sustainable public finances in the long run because of a reformed pension system, more healthy banks, weaker automatic stabilisers, and more fiscal credibility due to both a stronger fiscal framework and the earlier track record of budget consolidation.

Apart from evaluating fiscal policy and the fiscal framework, the council has in its first reports focused on evaluations of the government's labour market reforms. This has been a natural choice given that the prime economic policy objective of the current government has been to raise employment through sweeping labour market reforms. These reforms have entailed cuts in unemployment benefits for long-term unemployed, a financing reform of unemployment insurance and the introduction of an earned income tax credit. The reforms have been politically very controversial, with the opposition parties arguing strongly against them.

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<sup>15</sup> Finanspolitiska rådet (2008), Section 2.5, and Swedish Fiscal Policy Council (2009b).

<sup>16</sup> Fiscal Policy Council (2009a), Sections 1.1 and 1.4, Section 7.3.

Here the council's work has focused on evaluating the research basis for the reforms. The conclusions are that there is a sound research basis for believing that the cuts in unemployment benefits and the introduction of the earned income tax credit both will have substantial positive effects on employment in the long term, although the council dismissed the government's claim that these reforms were the main explanation of the employment increases that occurred in the 2006-08 cyclical upswing.<sup>17</sup> The council has criticised the government for not being willing to explain that lower unemployment benefits and the earned income tax credit are likely to promote job creation largely by inducing wage restraint.<sup>18</sup>

In addition, the council has been very critical of the way the government reformed the financing of income-dependent unemployment insurance, which in Sweden is run by union-affiliated unemployment insurance funds where membership is voluntary.<sup>19</sup> The financing reform implied a significant rise in membership fees which led to a mass exodus from the unemployment insurance funds, reducing the coverage of the insurance dramatically.

Finally, the council has had a number of critical views on the economic reporting of the government.<sup>20</sup> These criticisms have concerned *inter alia* the lack of reporting of the public sector's *total* net worth (in contrast to the careful reporting of *financial* net worth), non-transparent reporting of various government guarantees and other financial risks, very rudimentary reporting of government investment and of the development of the government real capital stock, and insufficient reporting of the size of various types of labour market programmes (which by tradition are very large in Sweden).

## 4.2 The council's impact

It is not obvious how to evaluate the impact of the council. The difficulties are compounded by the short time it has existed. One should distinguish between long-term indirect impact through influence on general thinking about economic policy and more

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<sup>17</sup> Finanspolitiska rådet (2008), Sections 7-8, and Swedish Fiscal Policy Council (2009a).

<sup>18</sup> See in particular Swedish Fiscal Policy Council (2009b).

<sup>19</sup> Finanspolitiska rådet (2008), Section 7.1, and Swedish Fiscal Policy Council (2009a), Section 5.3.1.

<sup>20</sup> Finanspolitiska rådet (2008), Sections 2 and 7, Swedish Fiscal Policy Council (2009a), Sections 3-5 and Swedish Fiscal Policy Council (2009b).

direct impact on short-term policy actions. The latter impact is more tangible, but the former impact may well in the end prove more important. I shall use three “metrics”: (1) media coverage (which may be related mainly to the long-term impact); (2) reactions from the political system (which is somewhere in between long-term and short-term impact); and (3) the extent of policy changes directly related to the council’s analyses (as a measure of short-run impact).

### *Media coverage*

The main media coverage occurs in connection with the publication of the reports, which are presented at press conferences. The presentations have been covered by the main TV and radio channels. The main national newspapers (both “general” and business) as well as most local newspapers have had both news articles on the main contents of the report and editorials discussing the conclusions. The public hearing in the Finance Committee in the parliament on the basis of the council’s report has been broadcast live on one of the state TV channels (but in daytime so the audience would not exactly compete with an evening reality show).

Although the main media coverage is in connection with the publication of the annual report, there is also a steady stream of articles, editorials and op-eds that refer to the council’s analyses in both the national and local press over the year. This impression of a “lasting influence” is supported by the pattern of downloads of the report from the council’s website, which shows a continuous interest (also with a very large number of downloads of the 2008 report in 2009) in addition to the spikes in connection with the publishing of the annual report. My general impression is that the council’s attempts to review both the pros and the cons of specific policies before taking a stand have been appreciated by the press. The council’s analyses have been extensively quoted by both left-wing and right-wing newspapers and magazines.

In addition, there has been a large number of interviews of the council’s members (and in particular of the chair) spread over the year on various issues of fiscal and employment policy. The council is to a large extent turned to when journalists want independent comments on both domestic and foreign (especially EU) macroeconomic

issues. The views of the council are on these occasions often contrasted with the views of the finance minister and the government in general.

#### *Responses from the political system*

Another way of “measuring” the council’s impact is to look at reactions from the political system. Both the finance minister and the economic spokespersons of the political parties have issued statements on the annual report when it has been published. The report is used as an input by the Finance Committee in the parliament when it evaluates the government’s spring fiscal policy bill: in this evaluation the council’s views are reported and commented upon.

In the government’s budget bill, which is presented to the parliament in the autumn, there is a special section that summarises the council’s report and takes a stand on the issues raised. This is in addition to references in connection with the discussion of the economic situation and the presentation of various policy proposals in the main text of the bill.

There have also been frequent references to the analyses and conclusions of the council in both the opposition parties’ economic proposals in the parliament as well as in the comments by MPs from both the political blocs in parliamentary debates.

#### *Impact on actual policies*

It would be notoriously problematic to evaluate the council’s impact on actual policy, since this would presume knowledge about the counterfactual. It is not possible to conclude whether – and if so to what extent – government proposals have been affected *ex ante* by the existence of the council and a possible desire to avoid potential *ex post* criticism.

One can look, though, at whether government proposals have been modified in response to views from the council. One does not find many such examples. But this should not be expected. For example, the council expressed *ex post* criticism of some government policies in its 2008 report: the lowering of the property tax (because it is less distortionary than most other taxes), the financing reform of unemployment insurance (see Section 4.1 above) and the implementation of reforms of sickness insurance (which



have had to be revised repeatedly). However, these reforms were announced already in the liberal-conservative parties' election platform in 2006 and were already then at the centre of the political debate. One cannot expect negative *ex post* evaluations of such reforms, to which there have been strong *ex ante* political commitments, to lead to large and immediate revisions. The government has, however, made some changes in eligibility rules with the aim of increasing voluntary membership in the unemployment insurance funds (though without addressing the fundamental problems).

The area where the council may have had the largest influence concerns the amount of fiscal stimulus in the recession. Here the council in its 2009 report argued strongly in favour of more temporary measures, including in particular extra grants to local government to maintain public consumption at a high level.<sup>21</sup> The government was initially very reluctant to do this, but then changed its mind in the 2010 Budget Bill presented in September 2009. The fiscal policy stimulus in 2010 is now close to what the council initially recommended (but the government rejected). It is possible that the council had an impact here, although similar recommendations were made also by many other players (including the OECD and the National Institute for Economic Research).<sup>22</sup> The government itself claims that its change of policy reflects a change in judgement about the risks of having to bail out Swedish banks and better long-term forecasts for public finances.

The council has had less impact when arguing against circumvention of the central government expenditure ceiling through changes in the timing of payments. The current government first announced in the Spring Fiscal Policy Bill that a temporary grant to local governments for 2010 would be paid out already in 2009 (the reason being a much larger budget margin below the ceiling in 2009 than 2010). This was criticised by the council in its 2009 report in May. But then the government in the budget bill in the autumn chose to do another similar operation. This was again criticised by the council.<sup>23</sup>

Another area where the council may be having some impact concerns the surplus target. Here, a review has been made by the finance ministry.<sup>24</sup> The review was decided

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<sup>21</sup> Swedish Fiscal Policy Council (2009a), Section 1.4.

<sup>22</sup> See, for example, OECD (2008) and the Swedish Economy, various issues in 2008 and 2009.

<sup>23</sup> Swedish Fiscal Policy Council (2009b).

<sup>24</sup> Finansdepartementet (2010).

already before the council was set up, but it appears that the review has been heavily influenced by the council's views. The review addresses the recommendations of the council in a systematic way. It makes a serious attempt to derive an appropriate numerical level for the surplus target from various underlying motives and to deal with the ambiguities in the follow-up of the target that arise from the large number of indicators used.<sup>25</sup> Although the attempts only address the concerns of the council to a limited extent, they still represent a step in the right direction. So does the review's recommendation that those future demographic strains on public finances deriving from increased longevity (and not from the exit of the baby-boom generation) should be met by increases in the retirement age rather than through pre-funding. The argument is that it is not reasonable that current generations should fund costs associated with the welfare gains for future generations following from the benefits of living longer.

Finally, there is the issue of reporting. Here the finance ministry has gone some way to respond to the council's demands for better reporting of total public sector net worth and real capital stock. The steps have, however, been surprisingly small and large deficiencies remain. This is even more so when it comes to reporting and analysis of public investment and labour market programmes in the spring fiscal policy and budget bills. A benign interpretation is that the ministry has been so preoccupied by the acute handling of the economic crisis that these improvements – which can be achieved with small resource costs and should be in the interest of everyone – have been assigned low priority. This interpretation receives some support from recommendations in the ministry's review of the surplus target to improve the reporting of public sector investment and capital stock.<sup>26</sup>

## **5 Issues of principle and the Swedish example**

The Swedish example can serve to illustrate a number of problems of general interest for the set-up and work of fiscal policy councils. I shall discuss the following issues:

1. The amount of resources required.
2. How broad should the remit be?

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<sup>25</sup> See Section 4.1 above.

<sup>26</sup> Finansdepartementet (2010).

3. The composition of the council.
4. How does a council get influence?
5. The council's role in the fiscal policy discussion.
6. The council in the general political debate.
7. The impact of the council on the standing of the finance ministry.
8. The council's independence.
9. Democratic legitimacy and the council's chances of survival.

### **5.1 The amount of resources**

A first issue concerns the amount of resources that a fiscal policy council should command. In an international comparison the resources of the Swedish Council look ridiculously small. The overall annual budget is around 700 000 €. It can pay only for a small secretariat (two researchers, one research assistant and one administrative officer) and the commissioning of 5-10 background reports from external consultants a year. As a consequence, the (academic) members of the council are expected to make heavy contributions to the writing of the report.

Can this work? This depends obviously on the environment in which the council finds itself. The resources of the council would not, of course, suffice for developing and administrating own large macroeconomic models, for making own macroeconomic and budget forecasts, for doing own fiscal sustainability calculations with a host of alternative assumption, for making detailed assessments of the fiscal consequences of various reforms or for auditing the government accounts. These tasks are instead performed by other already pre-existing institutions. The *National Institute for Economic Research*, which is another government agency, publishes regular macroeconomic forecasts. Another government agency, the *Office for Budget Management*, is responsible for continuously updating central government budget forecasts and for the annual financial statement of the government. The *National Debt Office* also makes central government budget forecasts. The *National Auditors*, an institution under the parliament with its independence granted in the constitution, have a broad mandate of monitoring and auditing all government activities.

These other institutions are giants compared to the Fiscal Policy Council and perform many of the tasks that a council could in principle also do. This means that the council can draw on their work and itself focus on broader and less routine evaluations regarding, for example, the overall thinking behind long-run fiscal sustainability judgements, the relationship between sustainability and medium-term fiscal objectives, trade-offs between sustainability and stabilisation, and the appropriateness of the fiscal stance in general and of specific tax and expenditure policies as well as of specific labour market reforms.

There is a certain overlap between the activities of the council and those of the other agencies mentioned. The National Institute for Economic Research makes judgements on the appropriate fiscal policy stance and on the effects of various tax and labour market reforms.<sup>27</sup> The National Auditors have, like the council, pinpointed various ambiguities in the fiscal framework and have also analysed effects of particular policies. In my view, such overlaps are not a problem. On the contrary, they contribute to a pluralistic policy discussion by highlighting issues from different angles. There is also a considerable amount of interchange between the council and the other agencies. The council sometimes commissions studies from the National Institute for Economic Research and organises joint internal seminars with it.<sup>28</sup> There is also a seminar interaction with the National Auditors.

So, the reason why the Swedish Council can function with only small resources is that it finds itself in an environment where there are also other larger agents doing related work. This does not mean that these agents dominate the council in the public discussion: it seems rather that the policy evaluations and recommendations of the council catch more media attention. A possible explanation is that the council's remit is to come up with a "verdict" on various government policies that enters directly as an input into the public debate.

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<sup>27</sup> However, a problem with the institute's analyses of the fiscal policy stance is that it is not always clear whether they represent recommendations or forecasts.

<sup>28</sup> The council's secretariat is physically located in the premises of the National Institute of Economic Research. The council's work is, however, performed in a completely independent way from the institute's. The institute has no prior knowledge of the contents of the council's reports.

Notwithstanding all this, the small resources of the Swedish Fiscal Policy Council raise an issue of sustainability of the whole set-up. As discussed above, the functioning of the council depends on the large inputs put down by its members. This work is performed as side activities in addition to full academic positions, but widely exceeds what is reasonable for such side activities. Long-run sustainability of the council would seem to require that members can be freed from part of their ordinary academic duties during their periods of office. This applies in particular to the chair of the council.

## **5.2 How broad should the remit be?**

The remit of the Swedish Fiscal Policy Council is much broader than according to most proposals regarding such councils. As discussed in Section 3.2, the remit does not only encompass evaluation of fiscal policy but also analysis of employment and growth developments. So far, the council has not ventured into the area of growth policy, but the reports have thoroughly analysed various aspects of the government's employment policy. This focus is explained by the emphasis of the current government on higher employment as its prime economic policy objective.

Is such a broad remit a good thing? There is obviously a trade-off. The broader the remit, the more difficult it is to penetrate an issue in depth. But the appropriate trade-off depends on the environment in which the council operates. As discussed in the previous section, other government agencies make more detailed assessments of the public finances, which makes it possible for the council to take more of an overall view.

A possible interpretation of the council's broad remit is that the prime objective is to help raise the general level of the public economic policy discussion. For this reason the council has focused a lot of its work on examining the research basis for various government policies and on whether the motives for proposals and the mechanisms through which various measures can be expected to work are properly explained. With this interpretation, the ultimate aim for the council is the fundamentally democratic one of giving citizens the information required to be able to make rational decisions on which policies they prefer.

The council's remit to evaluate various policies and the grounds for them comes very close to producing "verdicts" on their appropriateness. Full "verdicts" cannot be

delivered without also making pure value judgements. The council has tried very carefully to avoid this by evaluating policies only in relation to their aims as stated by the government. For example, when analysing the effects of cuts in unemployment benefits and the introduction of earned income tax credits, the evaluations have only focused on whether the measures are likely to achieve the stated objectives of raising employment, but not on the overall desirability when weighing these effects against those on income distribution.

### **5.3 The composition of the council**

The council is composed of six academic researchers and two former politicians.<sup>29</sup> The main writing work is done by the academics and the secretariat. Is it a good idea to mix academics and former politicians in this way? The former politicians have played an important role in the discussions of alternative proposals to those of the government – stressing the need for a reasonable amount of political realism – and for the phrasing and presentation of the reports. An important contribution has been to help keep down the level of technical abstraction such that the report is readable to a wider audience.

The presence of former well-known politicians has also played an important role for the legitimacy of the council. Their participation has helped to fend off the usual critique that academics are too far-off from the “real world” to be able to make useful inputs in the public policy debate.

Needless to say, it is important that the ex-politicians are really ex-politicians and do not follow a political agenda that could compromise the evaluations of the council.

### **5.4 How does a council get influence?**

In principle there are two polar ways for academics of trying to influence policy. One extreme is to work only through written reports and public discussion. The other extreme is to do policy advising behind the scene. The council has focused almost exclusively on the first model. There is a closed-room discussion with the finance minister when the annual report is handed over, but except for that the council’s members have taken a restrictive attitude to contacts with the government and have even declined invitations to

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<sup>29</sup> See also Section 3.1.

discuss policy in closed meetings with government ministers in between the reports. The motivation is that the remit to evaluate policy *ex post* would not be consistent with such *ex ante* policy advising. Such a double role would also threaten the credibility of the council as an independent institution.

It has been felt by the council that the best way of gaining sustainable influence is to build up a reputation for good, independent and critical analysis of government policy through its own reports and through various commissioned background reports.

### **5.5 The role of the council in the fiscal policy debate**

The original thought behind fiscal policy councils has been to strengthen the forces supporting fiscal discipline and long-term fiscal considerations. Does this mean that a fiscal policy council should always advocate a more restrictive fiscal policy stance than the government? This was more or less claimed by the Swedish finance minister in last year's public hearing in the Finance Committee in the parliament. There he expressed dismay over having created a body with the remit to strengthen the incentives for fiscal restraint and then finding that this body was more fiscally activist than the government itself.<sup>30</sup>

It is natural that fiscal policy councils for most of the time advocate more fiscal discipline than governments, since the latter are part of political processes where short-term considerations tend to dominate. But this does not mean that this must *always* be the case. Although there may be a deficit bias in the political process, it has also a strong tendency to build on very conventional wisdom and to adapt too late to changed circumstances. The council judged this to be the case in Sweden when the world financial crisis erupted in the autumn of 2008. The government was then so heavily influenced by the doctrine that active use of discretionary fiscal policy as a countercyclical tool should be avoided under normal circumstances that it had problems realising that the extraordinary circumstances motivated another stance, especially against the background of the strong public finances in Sweden. The council felt it had an obligation in this

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<sup>30</sup> Öppen utfrågning om Finanspolitiska rådets rapport den 19 maj 2009. A similar view was expressed by one of the finance ministry's state secretaries in a debate on the council's annual report in the Swedish Economic Association (Hanssen 2009).

situation to point to both the need and the room for countercyclical fiscal policy.<sup>31</sup> This was in line with its remit to consider both sustainability and the cyclical situation when evaluating fiscal policy.

There is also an important parallel to monetary policy. It is a common view that independent central banking, by enhancing the credibility of low-inflation policy, has made it possible to pursue more activist monetary policy rather than to have to follow more inflexible rules. A similar argument applies to fiscal policy. Stronger fiscal institutions – including fiscal policy councils to monitor fiscal policy – should increase the freedom of action to pursue activist policies and to apply fiscal rules in a flexible way.<sup>32</sup>

### **5.6 The council in the general political debate**

Both the council's *ex post* evaluations of the government's policy and its *ex ante* evaluations of government proposals act as inputs in the general political debate. This is in line with the council's remit to "increase the debate on economic policy in society". How does this come out?

Politicians do frequently refer to the analyses and conclusions of the council in political debates. Although references are often selective and sometimes provide a misleading picture, it must be judged favourably that such research-based inputs enter the political debate at all. The use of the council's analyses by *both* political blocs is likely overall to raise the quality of the arguments employed. An important role of the council's analyses is that they are used by journalists to confront simplistic argumentations by politicians.

#### *Is there a political bias?*

A potential problem concerns the possibility of a built-in *political bias* in the effects of the council's evaluations on the political debate. The council's remit is to evaluate the government's policies. To be useful, it is then natural that the analyses focus mainly on the scope for improvement rather than on praising the already good. So, the reports are

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<sup>31</sup> See Section 4.1 above. The argument is further elaborated in Calmfors (2009).

<sup>32</sup> This point has been stressed by, for example, Wyplosz (2002, 2005, 2007).



likely always to contain substantial parts that are critical of various government policies and recommendations on what the council regards as better policies. But the political opposition's proposals are not subjected to similar critical evaluations, since this is not part of the remit. This may create an impression that the council is more critical of the incumbent government's policies than of the alternatives proposed by the opposition, even when the reverse is the case. This seems to some extent to have happened, as the council has often been portrayed as the opponent of the government.

If such a built-in "bias" is to be corrected in the short term, it would probably require a change in the remit such that government policies and opposition proposals are evaluated symmetrically. This would imply a large extension of the task of the council and imply a role as a "scientific referee" in the political debate. In the long term, the bias problem will probably be less severe, as the public is likely to learn that the council makes critical evaluations of the policies of all governments.

There is, however, one sense in which the opposition is likely always to benefit more than the government from the existence of a fiscal policy council of the Swedish type. This is because a government has access to more analytical and "research" resources than the opposition. The opposition will therefore gain in relative terms from independent policy analysis of the type that the council provides.<sup>33</sup>

These conclusions go very much against the fears raised by the Left Party that "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".<sup>34</sup>

#### *The members and the council*

A delicate issue concerns the relation between the council and its members in the public debate. The council as a whole takes a policy stand only in the annual reports, but usually not in between the reports.<sup>35</sup> This raises the question of to what extent council members should express their opinions in the public debate since they may be confounded with the opinions of the council as a whole. The council has taken the view that it would not be consistent with the task to "work to achieve an increased public discussion in society on

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<sup>33</sup> See Calmfors (2006).

<sup>34</sup> Motion 2006/07:Fi7.

<sup>35</sup> According to the council's statutes, dissenting views on the reports must be made public.

economic policy” if council membership would restrict participation in the general debate. Therefore the council’s policy in this respect has been formulated in the following way:

“The council as a whole does not continuously take a stand on economic policy. But the council’s members participate in the public debate with their own views. They may, but need not necessarily, be shared by other council members”.<sup>36</sup>

In practice, it is, though, a problem that the views of individual council members (especially those of the chair) are often interpreted as being the views of the whole council. The publicly expressed views of council members can, however, to some extent be constrained by the knowledge that it may be embarrassing to express a strong view and then later have to accept a compromise in the council. On the other hand, a strong public commitment may, of course, as in all negotiations, be a means to improve one’s bargaining strength in the group.

A final problem concerns the behaviour of council members in connection with parliamentary elections. Members of the Danish Economic Council choose not to participate in the public debate during a period before elections. It is difficult to say whether such a policy is desirable. On the one hand, one could claim that the need for independent research input into the public debate is never greater than when citizens are to decide how to vote. On the other hand, the council does not want to be used as a “bat” in the election debate. The Swedish council does not have a policy on this as yet, but will need to formulate one before the next parliamentary election, which takes place in September this year.

### **5.7 The council and the standing of the finance ministry**

Another issue concerns the standing of the finance ministry within the government and in society as a whole. Research on the political economy of public finances has stressed the

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<sup>36</sup> This is stated on the council’s webpage: [www.finanspolitiskaradet.se](http://www.finanspolitiskaradet.se).

importance of a strong finance minister who can discipline the “spending ministers”.<sup>37</sup> It is not clear how this balance could be affected by a fiscal policy council.

On the one hand, the council’s evaluations could strengthen the hand of the finance minister in internal government discussions to the extent that the analyses of the finance ministry are backed up. But on the other hand, the council’s analyses could provide other ministers with alternative analyses which they would not have access to otherwise. Sometimes finance ministries adopt quite dogmatic approaches and present them as unquestioned wisdom, even though economic research might not warrant unambiguous conclusions. If so, the council’s evaluations might provide a more balanced picture.

A related aspect concerns the balance within the finance ministry between the political leadership and the unpolitical civil servants (technocrats). There seem often to be on-going debates within the ministry where the technocrats question the research basis for more politically motivated measures. Here, the council’s analyses could strengthen the hand of the technocrats by giving them outside support.<sup>38</sup> In general, the existence of the council might increase the willingness of the political leadership to supply more resources for analytical work so as to reduce the risk of being criticised for badly prepared proposals.

### **5.8 The council’s independence**

A well-functioning council requires a high degree of independence from the political system in analogy with what is needed for central banks. A first issue here concerns appointments. The members of the Swedish Fiscal Policy Council are appointed by the government on three-year terms, which can be renewed. This represents a potential risk. This risk is, however, balanced by the stipulation that appointments should be made after proposals from the council itself. This creates a reputational cost for the government of not following the proposals. The council has tried to increase this cost by announcing its proposals for replacements publicly without any prior consultation of the government. There have so far been three cases where members have stepped down and have been

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<sup>37</sup> See Hallerberg and von Hagen (1999) or von Hagen (2002).

<sup>38</sup> See also Calmfors (2008).

replaced. In all three cases the government has followed the proposal by the council, so this practice seems now to have been established.

The risk that council members should adapt in an improper way to the government in order to be reappointed is also reduced by the low pay for the job (1000 € per month for an ordinary member, 1500 € per month for the chair) relative to the effort involved. This makes it clear that council membership is a service to society rather than a benefit for the members.

It is a potential problem that the council is an agency under the government rather than under the parliament. Having put the council under the parliament (like with the National Auditors) rather than the government would have further stressed its independence. It is not a good arrangement in principle that the chair of the council now – like the head of all government agencies – is obliged to have a regular annual meeting with the state secretary formally responsible for the council (in this case in the finance ministry) where the council's performance (in evaluating the ministry) is discussed. Nor is it a good arrangement that the budget has to be negotiated with the ministry. These arrangements have so far not been misused, but the whole construction implies a potential risk for exerting undue pressure from the government. In practice, however, this risk may to some extent be reduced by the reputational cost the government might suffer if it were to be known that it had responded to criticism from the council by restricting its budget. But in a situation where the council was initially heavily underfunded, the budget dependence on the government does create an unfortunate situation.

The most important guarantee for independent evaluations by the council is probably the fact that the majority of the council is made up by academic economists, who are active mainly in another arena than that of the council.<sup>39</sup> There would be a high reputational cost in the academic arena for researchers who were seen to be acting in a political way in the council rather than making research-based recommendations.

One should, however, be aware of the risk in a small country like Sweden that derives from the fact that – almost – everybody in a field such as economics knows each other. This implies that council members are likely to be evaluating people they know well and may have worked or studied together with. This might create a psychological

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<sup>39</sup> See Calmfors (2006, 2008).

bias sometimes to be “too kind”. This is an argument for the council to rather err on the “tough” than on the “soft” side.

### **5.9 Legitimacy and survival of the council**

A criticism sometimes advanced against the council is that it is “undemocratic” to have unelected experts evaluate elected representatives.<sup>40</sup> According to the argument, this would give technocrats (academic economists) too much power relative to politicians. The obvious counterargument is that the council provides a basis for decisions that takes account of both preferences and constraints in a more rational way than would otherwise be the case. By providing better information for citizens, their possibilities of holding policy makers accountable are increased.

Will the Swedish fiscal policy council survive? My judgement is that, although the current government has sometimes expressed irritation over the council’s specific conclusions, it still appreciates that the council’s monitoring is important. The government continues to emphasise that the establishment of the council represents an important addition to the fiscal framework.<sup>41</sup>

It is more difficult to judge the opinion of the opposition parties and how they would act if they were to win the next election. As discussed in Section 3.1, all the opposition parties voted against the establishment of the council in 2007. However, in 2008 and 2009 only the Left Party proposed in the parliament that the council should be abolished, whereas the Social Democrats and the Greens did not. In a recent agreement among the three opposition parties on the closing down of a number of government agencies the fiscal policy council was not included. All three opposition parties have also made frequent references in the political debate to critical evaluations of government policies by the council.

So, it is difficult to predict what would happen if the opposition were to win the election that takes place this year. It is possible that the Social Democrats and the Greens

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<sup>40</sup> The Social Democrats argued in a way that could be given such an interpretation when the council was established. The formulation used was that “ultimately it should be the elected representatives of the Swedish people who evaluate the policy pursued”. They went on to argue that “for this reason we reject the government’s proposal to give a fiscal policy council the task of evaluating the contents of policy” (Motion 2006/07:Fi10).

<sup>41</sup> See, for example, Ministry of Finance (2009) and Finansdepartementet (2010).

have changed their views. There have been some comments in editorials in the Social Democratic press over the last two years that they ought to do so. In the current economic situation the Social Democrats and the Greens might also judge it to be a negative signal for the credibility of fiscal policy to abolish the council. But one cannot rule out that they might want to draw on the council's critical evaluations of some government policies before the election and that they do not for this reason want now to undermine the credibility of the council, even if it is to be abolished later. There is, of course, also the possibility that a new government could change the council's remit, for example by extending it to include also monitoring of income distribution effects. This would, of course, distance the council's task even more from the narrower task of being mainly a fiscal policy watchdog.

## **6 Concluding comments**

The Swedish Fiscal Policy Council differs from most proposals on fiscal policy councils in two major respects: the amount of resources and the breadth of the remit.

The Swedish council has very small resources. Resources are probably too small for a sustainable activity. However, the Swedish case does illustrate the importance of the environment in which a fiscal policy council operates. In Sweden there were a number of other pre-existing agencies with substantial independence from the government (by law or by tradition) performing some of the tasks that could also be done by the council. These other institutions are responsible for both macroeconomic forecasting and more detailed budget evaluations. This has allowed the Swedish council to focus on more overall judgements with a heavier academic input.

The Swedish Fiscal Policy Council has a very broad remit. It should not only focus on long-run fiscal sustainability issues but also judge fiscal policy from a cyclical point of view. This is in accordance with some earlier proposals on fiscal policy councils, which have emphasised such a council's role in judging the appropriate fiscal policy stance taking both long-run sustainability (or medium-term fiscal targets) and stabilisation aspects into account.<sup>42</sup> But the remit to evaluate employment and growth

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<sup>42</sup> See, for example, Wyplosz (2002, 2005) and Calmfors (2003a, 2003b, 2005) for surveys of such proposals.

developments as well as to monitor the clarity of and research basis for government policy proposals goes beyond most of the earlier discussion on fiscal policy councils.

A possible drawback of the Swedish council's broad remit is that it could impair its role as a fiscal policy watchdog. This risk is illustrated by the fact that the council's views on countercyclical policies in the current recession and on various controversial labour market reforms carried out by the government have received more attention than its views on fiscal sustainability issues. On the other hand, there is a logic in analysing both employment and growth together with fiscal sustainability, since the former are crucial determinants of the latter.

The Swedish council's advocacy of stronger fiscal stimulus in the beginning of the current recession than that pursued by the government might at first sight appear surprising. It is not, however, if one recalls that a strong government commitment to fiscal discipline and the establishment of a fiscal policy council can both be seen as being caused by a strong political focus on stable long-run public finances (rooted in the distressing experiences of fiscal crisis in the 1990s). Although one should expect that a fiscal policy council will on average be in favour of smaller deficits than the government, this need not be the case in every situation. A council should, of course, make its own judgements of every situation. This is likely to give more long-run credibility for the council's judgements than to mechanically choose always to be more restrictive than the government.

A specific feature of the Swedish Fiscal Policy Council's remit is the task to monitor the motives, the research basis and the explanations for policy proposals given by the government. One could interpret this to be the most important task since it is basically a fundamental service to democratic decision-making to help provide as good input as possible in the public policy debate. Why has the Swedish council been given this task? A possible answer is that there is a long tradition in Sweden of academic economists participating and having a high profile in the public debate. It goes back to economists like Knut Wicksell (who was jailed for blasphemy in public), Gunnar Myrdal (who was a Social Democratic minister), Bertil Ohlin (who was leader of the Swedish Liberal Party), Erik Lundberg (a contemporary of Keynes developing similar thoughts) and Assar Lindbeck (who for many years was a dominating figure in the Swedish

economic policy debate). Today – with the greater specialisation of economic research that has occurred – it is much more difficult to do both qualified research and to participate in the public policy discussion. The establishment of a fiscal policy council with the tasks it has in Sweden can be seen as an attempt to institutionalise a high degree of interaction between academic research and practical economic policy, by seeing to it that at least some academics participate in the economic policy debate and feel the need to keep themselves continuously updated before they speak.

The main lesson from my discussion is probably that there can be no uniform model for fiscal policy councils. The pre-existing institutional set-up, traditions, historical experiences and policy problems differ among countries and make it natural to choose different institutional arrangements. To be successful, these need to take due account of the special characteristics of each country.



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