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MTEF in Sweden¹ (1)

MTEF Case Study

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PRESENTERS

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1. Background

A. Constitutional arrangements

Sweden is a constitutional monarchy and the King is the Head of State. His duties are, however, mainly of a representative and ceremonial nature. The Constitution, based on the principles of popular sovereignty, representative democracy and parliamentarism, thus begins by stating that "all public power in Sweden proceeds from the people".

Sweden has a unicameral parliament, the Riksdag, with 349 seats. Elections are by proportional representation. The electoral system is designed to ensure a distribution of seats between the parties in proportion to the votes cast for them nationally. A party must gain at least 4% of the national vote to qualify for representation. Elections are held every four years. The Riksdag, upon a proposal by the speaker of the Riksdag, appoints a Prime Minister who is given the task of forming a government. The Prime Minister chooses his/her ministers and together they make up the Swedish Government. The Government is accountable to the Riksdag.

The Swedish Constitution consists of four separate documents. Of those, the Instrument of Government (*Regeringsformen*), together with the Riksdag Act (*Riksdagsordningen*), which occupies a position midway between constitutional and regular statute law, set the overall framework for the budget and the budget process. The structure of the budget and the budget work is regulated by a Budget Act which is a regular statute law.

B. Reforms

The present structure and the procedures for preparing and deciding on the budget are the result of a series of reforms initiated and implemented in a very short time in the middle of the nineties. The impetus to the reform came from the very deep crises affecting the national economy and the government finances at the beginning of the 1990'ies.

When analyzing the crises, it was found that one of the contributing factors to the crises was a very lax budget process. One of its consequences was a seemingly unstoppable growth in the relative size of the public sector and thus the tax burden. Furthermore the Swedish public finances had become extremely sensitive to the swings of the business cycle because of the dominant role of transfers to households in government expenditure. As long as these swings were moderate, the opposing effects on government revenue and expenditure served as automatic stabilizers. External shocks of the magnitude experienced in the early nineties, however, took the economy "out of bounds". The central government deficit exploded and reached 12 percent of GNP in 1993. The gross financial debt peaked at 77 percent of GNP in 1996.

In order to reduce the swings in the budget balance but also – and perhaps more importantly – to create a semi-automatic mechanism for containing the growth and eventually reducing the size of the central government, the traditional incremental bottom-up approach to budgeting was replaced by a very strict top-down process.

C. General characteristics of the Swedish public financial management

Subsequent to the reforms of the mid-1990ies, public financial management now has a three-year perspective within a top-down framework. This three-year perspective and the top-down approach apply to budget preparation as well as to the decision-making process in the Riksdag.

Execution of the budget is fully decentralized to the agencies responsible for executing the some 500 appropriations. Appropriations for the administration of the agencies are given as block appropriations, i.e. the agencies are completely free to decide on the input-mix required to achieve the objectives established for its operations. Objectives, targets and general reporting requirements are stated in the yearly “letter of appropriation” (See further below)

For many agencies, central financing from the Treasury is supplemented by or, in some cases, completely made up of revenue accruing directly to them in the form of fees and sales revenue. To give additional financial flexibility, the agencies have the right, up to a limit, to carry over unused appropriations to the following year. They can also, within limits, borrow against next year’s appropriation. Investment is financed by internal loans issued by the Swedish National Debt Office. Payments are made directly by the agencies and the accounts are kept according to generally accepted accounting practice i.e. the type of accounting used private enterprises. The main instrument against overspending is agency self-discipline. The accounts of every agency are audited by the Swedish National Audit Office (Riksrevisionen). The audited accounts are presented in a yearly report together with a review of activities of the past year put in relation to the objectives and targets set in the letter of appropriation.

2. Foundations of Budget Preparation: level 1

A. Actors in budget formulation

Budget formulation involves, in one way or another: the Riksdag, the Office of the Prime-Minister, the Ministry of Finance, the line ministries¹ and the agencies.

B. Macro-forecasting

Macro-forecasting is mainly carried out by the Department for Economic Affairs (DEA) at the Ministry of Finance. The work carried out in this department builds on work by and material from the National Institute for Economic Research (NIER), the Department for National Accounts at Statistics Sweden, the National Tax Board, the OECD and other international institutions. For the component that refers to public sector consumption, DEA receives input from agencies and line ministries channeled through the Budget Department. The Financial Markets Department within the Ministry of Finance provides input on financial variables, notably interest rates.

¹ The Office of the Prime Minister and the Ministries together make up the “Government Offices”.

Besides providing input to the forecasting work of the DEA, NIER produces its own independent macro-economic forecasts. Macro-economic forecasts are also produced by the major banks and other private sector institutions. The existence of multiple forecasters serves as a check on the forecasts made by the DEA.

Short-term macro-forecast are based on a set of partial simulation models but outcomes of those are adjusted on the basis of judgment backed up by a set of quick indicators. Medium-term models rely more heavily on models. DEA uses a stripped-down version of a partial equilibrium model developed by the NIER. Work is on-going at the NIER to develop a more sophisticated scenario-type model.

The process at DEA generates forecasts for a number of variables that are subsequently used as inputs in the forecasting of government expenditure, for example: nominal GNP, nominal GNI, household consumption, CPI, interest rates and employment.

DEA produces four to six complete forecasts during a year. Two of those are published -those on which the Spring Finance Bill and the Budget Bill are based.

The ambition is to produce as accurate forecasts as possible. The political level at the Ministry of Finance has largely refrained from trying to influence the forecasts knowing well that any manipulation would jeopardize its credibility. The existence of alternative forecasts - those of the NIER and private sector institutions - also serve as a check on the official ones. Contrary to what is done in some other countries, for example Canada, there is no systematic conservative bias introduced into the forecasts. The need for a buffer to absorb external shocks is instead met by an explicit budget margin on the expenditure side of the budget.

C. Revenue forecasting

Revenue forecasting is primarily the responsibility of the Fiscal Affairs Department at the Ministry of Finance. In-year revenue forecasting is also done by the National Financial Management Authority (ESV). Detailed information on debited taxes and tax payments is provided by the National Tax Board.

Forecasts are made in accruals as well as in cash terms. The forecasts are made with the help of a set of partial models - one for every type of tax.

D. Debt policy

The management of the central government debt is the responsibility of an independent agency, the Swedish National Debt Office (SNDO). Its objective is to borrow at the lowest possible cost, taking into account risk. General guidelines for the management are established by the Government on the basis of proposals by the SNDO. Proposals for the coming year are presented to the Government in October every year. The proposal covers a three-year period, year two and three being preliminary. Once decided, the Board of the Debt Office sets detailed guidelines for next year's work.

For 2004, for example, the Government reiterates its long-term aim to reduce foreign currency debt as a percentage of total central government debt. The medium term target is for foreign denominated debt to amount to no more than 20 percent at the end of 2006. For 2004 the target for amortisation of foreign debt is SEK 25 billion. However, the Debt Office has the mandate to deviate from this target by +/- 15 billion should conditions in the market change. The Debt Office is furthermore instructed to increase the proportion of inflation-linked krona-denominated loans. The benchmark for the average duration of the nominal krona and foreign-curren

cy debt is to remain unchanged at 2.7 years.

E. Expenditure forecasting and fiscal envelope

As a starting point for every budget round, a baseline is estimated. The base-line, termed "consequence assessment", is an estimate of what would be the outlay for every single appropriation and, thus, for the aggregate budget. The baseline presumes no change in policy and no change in activity volumes except for those that follow from decisions made in earlier budget rounds. The baseline thus only takes into consideration changes in factors that are beyond the immediate control of government, such as changes in prices, wages, exchange rates and interest rates. To increase accuracy and fairness, a number of more focused price indices – not just CPI – are used. For the appropriations for normal administrative costs of agencies, three indices are used: for wages, for rents and for other operational costs. From the thus reflatd initial baseline estimate is then deducted a variable percentage to reflect presumed efficiency gains. The efficiency factor, which is based on national accounts statistics, concretely a moving average for the preceding ten year, has in recent years hovered around 1.5 percent.

For appropriations like defense and infrastructural investment other types of specialized indices are used.

The models used to produce the baseline estimates vary a great deal in complexity. Some are quite simple doing nothing more than reflatd last year's appropriation – adjusted for presumed efficiency gains. Other models, in particular those referring to some of the entitlement programs, are more complex. Some simulations use a sample of individual household data as its basis; others more aggregate data. All models are partial but estimated feed-back effects are incorporated into successive forecasting rounds.

At present, the responsibility for the different models is largely decentralized to line ministries and sometimes to the responsible agencies. At the beginning of the exercise, Ministry of Finance, however, makes available a set of parameters – assumptions regarding the evolution of the different price indices, GDP growth rates, unemployment etc. – to the forecasting institutions. Sometime in the future, the models will be incorporated into the government-wide budgeting and reporting system that is in the process of being developed.

3. Allocation: level 2

A. Global expenditure ceiling

Global expenditure ceilings are set for three years on a rolling basis. I.e. every year a global ceiling for year $t+3$ is established. Beginning 2002, the Government's firm proposal is presented in the Budget Bill and voted on by the Riksdag in the fall.²

The Riksdag's decision on the expenditure ceilings are, strictly speaking, not legally binding but in practice they have held firm.³ The over-all ceiling has become almost

² During the first years after the introduction of the new budget process, it was presented in the Spring Finance Bill and voted on separately. The rationale for presenting and voting on the global expenditure ceiling separately in the spring was to put focus on the longer-term fiscal issues. However, it, in practice, led to two budget processes – leaving very little time for follow-up of government programs – and the proposal and the discussion on the global expenditure ceilings have now been shifted to the fall.

³ Contrary to the Latin tradition, budgets in Sweden do not have the status of laws.

sacrosanct, while its break-down into expenditure ceilings is more indicative and finds its final form only for the up-coming year.

The process in which the global expenditure ceiling for year t+3 is set not entirely straight-forward, being partly technical, partly political. The starting point is a forecast of central government revenue based on the existing tax structure and existing tax rates plus any already decided on changes in the latter. From this revenue estimate is deducted the business-cycle adjusted surplus target and the target budget margin in order to arrive at the global expenditure ceiling. The present surplus target is an average of 2 percent of GDP over the business cycle and the target budget margin for year t+3 is 1.5 percent of total expenditure. If year t+3 is forecasted to be a boom year, the surplus target should in principle be adjusted upwards – and vice versa. In mathematical notation:

$$C_{t+3} = R_{t+3} + \Delta T_{t+3} - \hat{S}_{t+3} + M_{t+3}$$

where C = ceiling, R = revenue, T = taxes, \hat{S} = surplus target, M = budget margin.

Underlying this approach to the expenditure ceiling – coming in from the revenue side – is, or at least was, a concern about the tax burden in general and the marginal effects in particular. The concrete effect was, as the Swedish economy recovered from the crises of the early-mid nineties, a dramatic lowering of the proportion taken up by general government in the economy: from 70 percent to 55 percent measured on the expenditure side. In the last three years, this down-ward trend has, however, leveled off at about 55 percent.

The revenue projections are, however, not end of story. Expenditure is also forecasted making in effect ΔT_{t+3} in the formula above to some extent endogenous. Should the projections of growth in the economy, and thus of revenue, point to a surplus beyond the desired surplus target and the target budget margin, the Government can decide to lower taxes and/or increase expenditure. If the opposite would obtain, expenditure will have to be curtailed and/or taxes increased.

The budget department prepares a number of scenarios which are presented to the Minister of Finance and the Prime Minister who in the end make a political choice as to the exact level of the expenditure ceiling.

One technical aspect of the expenditure ceilings is worth pointing out; they are expressed in nominal terms. A nominal ceiling on government expenditure adds credibility to the inflation ceiling established by the central bank. It is particularly important in a country, like Sweden, where the public sector occupies such a large share of the national economy.

The total expenditure ceiling for year t+2 may, in principle, be altered but the Government has so far chosen to confirm the one established the year before, save for any adjustments for technical reasons.

B. Expenditure area ceilings

The ceiling for t+2 becomes the starting point for the process of preparing the detailed budget the subsequent year. During the first years after the budget reform, the Government prepared and Parliament decided on indicative expenditure ceilings in the spring. This is no longer the case. Nevertheless, the Government, in its March retreat, decides internally on the expenditure area allocations and those allocations serve as guidelines for the preparation of the detailed budget proposal, i.e. the proposed allocation to the approximately 500 appropriations.

The starting point for the allocations between the expenditure areas is the baseline calculations or consequence assessments described above. The line ministries also present

budget requests on the basis of requests prepared by the agencies under their jurisdiction. In these requests the ministries may argue for higher allocations to particular areas and they are not, at least not in practice, constrained by the expenditure area ceilings decided on by Parliament in the previous fall. What ensues is a rather intensive negotiations process involving the line ministry and the Budget Department within the Ministry of Finance – and to the extent necessary the Minister of Finance and even the Prime Minister. However, once the expenditure ceilings are set by the Cabinet in March, they, in principle, have to be respected when making the final allocation to individual appropriations presented in the Budget Bill. Some adjustment may have to be made for technical reasons or because some fundamental assumption, for example, on employment/unemployment, has to be revised.

The budgeting process is thus fundamentally incremental, albeit within the confines of the global and the expenditure area ceilings. There is definitely no zero-based budgeting taking place and there is no systematic attempt at estimating the return on government spending in different areas. Nor is there really any systematic use of information on results and of all other types of information that agencies are required to feed back to the Government Offices and to Parliament.

Attempts at basing the budget process on and around a more streamlined programmatic structure for the budget, allowing a systematic feed-back and analysis of outputs and outcomes, have, at least for the time being, got bogged down; a new programmatic structure has been introduced and should, in principle, be used for reporting, but budgeting and the allocation of resources is still made in the old structure severely limiting the usefulness of the reform.⁴

C. Conflict resolution and consensus building

One important factor which facilitates decision-making in Government is that all decisions are taken by the Cabinet as a collective body. There is thus less scope for bilateral negotiations between line ministers and the Minister of Finance. Just as obtains for the decision-making process in Parliament, any minister arguing for an increase of spending in his or her area must be ready to confront his or her fellow ministers with proposals for where the funding for it – in the form of reducing spending in competing areas – should be found.

Most decisions of a more detailed nature are taken at a lower level in the Government Offices, either within line ministries or in negotiations between the Budget Department and the line ministries. Despite the new top-down process, the Budget Department has a tendency to get involved in rather low-level issues, issues that presumably, given the existence of expenditure areas ceilings, could be handled within the respective line ministries. However, well established procedures for handling differences of position do exist; outstanding issues are raised to successively hierarchically higher levels – if need be to the Prime Minister – until they are resolved.

D. Effect of ceilings

The top-down approach to budgeting has not completely closed the window for intra-governmental negotiations. Although line ministries, in principle, ought to respect

⁴ The duplication of structures will undoubtedly prove untenable and in time a replacement of one for the other or some type of merger of the two will necessarily have to be engineered. As a trial balloon an accrual-based shadow budget for 2004 will be presented for information purposes. The shadow budget will be broken down by policy areas rather than by expenditure areas.

the ceilings established by the Riksdag, they often do use their budget proposal as a vehicle for demands for additional funding. These proposals can, however, not be wildly out of line or they would not be taken seriously. The ceilings thus act as a restraint but not as an absolute constraint on the agency and line ministry proposals. One could also argue that, for want of a more systematic and structured way of assessing the effectiveness of government spending, in particular of larger programmatic aggregates, agencies and line ministries should have at least one formal channel for arguing their case.

E. Final budget allocation

The proposed allocation between expenditure areas and within expenditure areas is finally established in the Budget Bill. The final inter-expenditure-area allocations correspond very closely to those decided on in the March retreat by the Cabinet. The difference between the two has, in recent years, been less than one percent and almost solely in entitlement programs where changes in the macro environment and/or in other external factors have necessitated a review of the forecasts. In principle these changes – normally increases – should be absorbed by a reallocation within or between expenditure areas. In practice they have, in most cases, led to a reduction of the budget margin.

The differences between the provisional inter-expenditure allocations presented for t+2 in the Budget Bill one year earlier and the eventual final allocations have tended to be considerably bigger. In the two most recent Budget Bills, the importance of the expenditure area breakdowns for t+2 and for t+3 have been downplayed by only requesting the Riksdag to “approve of the forecasted consequence assessments” rather than to set firm ceilings. In next year’s budget round, the allocations for t+2 may again be given a more definite status while those for t+3 are likely to continue to be only indicative and based on the presumption of no substantive changes.

F. Roles within the administration

The division of responsibilities within the Government Offices

The introduction of the top-down budgeting model has, on the one hand strengthened the role of the Ministry of Finance in regard to the major allocative decisions. At the same time it has given the line ministries greater responsibilities for the allocation of budgetary resources within the different expenditure areas.

In principle, one could conceive of the responsibilities for deciding on individual appropriations being fully delegated to the line ministries. This, however, has not happened. The Budget Department, for good or bad, still tends to get involved in many detailed decision at intra-expenditure-area level. The justification for this is a blanket rule that the Budget Department should be involved in any decision that has financial consequences. Generously interpreted that could mean that the Budget Department ought to get involved in just about every single decision on the budget. On the other hand, with the top-down decision-making mechanism in place, any effects on aggregate spending are already effectively blocked. The department’s involvement in the details is really more a question of old habits taking a while to die. The present culture at the Department was also very much set during the days of the financial crises when the Department’s singly most important task was to scour the budget for potential expenditure reductions.

The Department is still largely staffed with relatively young professionals for whom a couple years at the Budget Department traditionally have served as a catapult to good

careers in other parts of the public sector.⁵ The increased responsibility for the allocation of resources between expenditure areas has not yet led to any noticeable changes in staff composition or any systematic up-grading of staff skills, although it ought to have.

In the line ministries, the units responsible for the coordination of budget work have come to play a more important role. It is difficult to say whether there has been any systematic up-grading of staff skills.

The role of the politically appointed officials

The Budget Bill, which consists of some 2,500 pages, is prepared by the technical staff of the Government Offices. The political appointees in the form of Ministers, State Secretaries and their political advisers are, however, more or less heavily involved in any policy issues reflected in the budget – for example the allocation of resources between expenditure areas. The Finance Minister is obviously interested in taxation issues and he follows very closely the financial execution of the budget, given the very substantial political capital invested in the global expenditure ceiling. In recent years he has, because of insufficient budget margins, been forced to decide on more or less transparent ways of slipping under the ceiling. The most important trick in volume terms has been to transform straight expenditure into tax expenditure, i.e. tax exemptions tied to specific activities. Common year-end measures have been to postpone payments to the following year. In total volume terms these maneuverings have, however, been quite limited, never surpassing one percent of the total budget. Their cost has been more political than economic.

4. From formulation to enactment

The Parliamentary process

The top-down multi-year budget introduced in the middle of the nineties stands on two equally important legs: the top-down budget preparation process and the top-down decision-making process in the Riksdag. The ever-increasing size of the public sector had to do as much with the decision-making process in parliament as it did with conscious political choices by the party that has been in power for most of the time since the 1930ies, the Swedish Social Democratic Party. It was very easy for a coalition of parties or even of individual MPs to propose and gain acceptance for proposals for increased spending in particular pet areas. They could do this without having to take any responsibility for how the proposed increased spending was to be financed. The importance of this type of dynamics became evident in the early nineties when a coalition of presumably more fiscally conservative parties in practice was held together largely by accommodating each single partner's spending preferences – at the expense of the advocated budget discipline.

With the new process, no new proposal for spending can be put forth by members of parliament without a matching proposal for how it is to be financed – in concrete terms what other spending is to be reduced since the global ceiling is fixed by an earlier decision.

As explained above, the global expenditure is set on a rolling basis for three years. Each year a new year is added and the ceiling for year t+2 is reconfirmed, possibly with some changes mainly for technical reasons.

The decision process on next year's budget begins with a new decision on the global

⁵ There are signs that that may now be changing with a general tightening of the public sector job market.

ceiling. This decision is taken as a package together with the allocation to the 27 expenditure areas and any changes in taxation that will affect the revenues of the government's. The decision also includes an acknowledgment of the revenue estimates prepared by the Government.

The package proposal is prepared by the Finance Committee and voted on by the full house. The composition of the Finance Committee reflects that of the house, thus, in practice, the proposal prepared by the Finance Committee corresponds to that of the Government's – except possibly for some minor details.

Once the global ceiling and the expenditure area ceilings are established, proposals for the break-down of the expenditure ceilings into a total of some 500 appropriations are prepared by the committees responsible for the different areas. These proposals again, largely, correspond to those of the Government's. The detailed allocations are voted on as a package, expenditure area by expenditure area.

In principle, the Riksdag is supreme in relation to the budget. However, the rules of the voting in the Riksdag on the budget are such that in order for the proposals prepared – by the Finance Committee for the area ceilings and by the other standing committees for appropriations – to be overthrown, the opposition will need to agree on one single package to be put up against that of the government's. In proportional electoral systems, such as the Swedish one, this type of voting arrangements strengthens the hand of the government's considerably – making it possible for minority governments to govern. In recent years, the Social Democrats have nonetheless chosen to routinely engage in a dialogue with two opposition parties, the Greens and the Leftist Party, in order to ensure their prior support for the budget proposal although, arithmetically speaking, they do not need to.

Once the budget proposal is finished and transmitted to the legislature, the executive has a very limited role as regards its enactment. The decision on the final proposal, i.e. what is reflected in the Budget Bill, is taken as a collective decision by the Cabinet. All ministers are thus bound by it and would not conceive of arguing against it, at least not publicly.

As soon as all decisions on the budget are taken by the Riksdag, the line ministries, in close collaboration with the Budget Department, prepare Letters of Appropriation through which the agencies are formally informed of the appropriations for which they are responsible and of the conditions, objectives and reporting requirements associated with those appropriations. Letters of appropriation may be prepared for single appropriation or for a set of appropriations under the jurisdiction of one agency. The letters of appropriation may vary a bit in character depending on the nature of the appropriation, but when it concerns the operation of an agency, they will contain a section on objectives, results indicators and special reporting requirements, a section on assignments (tasks) for the coming year, and a section on the financing of the activities of the agency. The latter includes: a) the appropriation for the year, b) an indication of any planned use of carried-over appropriations, c) a ceiling on the appropriation credit, i.e. the right to borrow against next years appropriation, d) an estimate of fee revenue that will be under the control of the agency, e) a ceiling on borrowing for investment in fixed assets, f) a ceiling on credit to meet short-term cash-flow needs, and g) any explicitly authorized, special, longer-term or multi-year commitments.

In parallel with the preparation of the letters of appropriation by the Government, the Riksdag compiles the final central government budget and hands it over to the Government a few days before Christmas.

5. Execution

Once the budget is enacted and the letters of appropriation issued, the execution of the budget is fully delegated to the agencies. For the framework appropriations financing the administrative expenses of agencies, one twelfth of the yearly appropriation is transferred monthly to interest-bearing accounts within the government group account held in one of the commercial banks.⁶ Payments are executed by the agencies themselves without the intervention of any central government treasury. Should the need for liquidity exceed what is available, it is met by a credit facility attached to the bank accounts.⁷

The strict annuality of traditional budgetary principles is, thus, done away with and all control of execution is ex post. Within the more flexible framework created by block appropriations, carry-overs, appropriation credits, loan and credit facilities, the agencies are expected to, and in fact generally do, behave responsibly.

The accounting is decentralized to the agencies and the accounting is done according to general accepted accounting principles, i.e. the principles that are used in the private sector world wide. The general accounts are complete, i.e. they, besides the central funding, include all other revenue such as sales income and fees, all expenses, and assets and liabilities. The follow-up against the appropriations – sometimes called the budgetary accounting – is integrated into the general accounts.⁸ Information from the budgetary accounts is transferred monthly to the central government financial management information system. Complete, accrual-based accounts for all individual agencies are prepared twice a year and consolidated into aggregate accounts for the entire central government. This is done by the National Financial Management Authority.

All agencies are subject to financial audits every year and performance audits are carried out as necessary. With the creation of the new Swedish National Audit Office under the Riksdag, the consolidated accounts will also be audited. Another mechanism to stimulate good and responsible financial management is a yearly rating of the agencies done by the National Financial Management Authority.

6. In-year changes in the budget

Supplementary estimates are prepared and presented to the Riksdag twice a year in connection with the Spring Financial Bill and with the normal Budget Bill in September. Any proposal for new spending must be accommodated within the global expenditure ceiling – normally within the relevant expenditure area ceiling – i.e. it must be accompanied by a proposal for reductions in other areas. Nothing else would be acceptable. The costing for any new proposals is done in the same way as for a regular proposal presented in the Budget Bill. The number and volume of new proposals is, however, quite limited. Rather than vehicles for new proposals, supplementary estimates

⁶ In the near future, the Government will tender for payments and group account services from several banks. The Swedish National Debt Office is responsible for the oversight of government payments and is responsible for the over-night clearing of the group-account(s).

⁷ As regards transfer payments, they are also channeled through sub-accounts of the government group account but are replenished on the day of payment from the general government account controlled by the National Debt Office.

⁸ This integration is, however, not entirely straight forward and transparent because the budgetary accounts follow different principles than those of the general accounts. Efforts to fully integrate budget follow-up into the general accounts by defining the appropriations in terms that are fully compatible with those of accrual accounting have got bogged down.

have, in recent years, been necessary to handle unexpected volume increases in entitlement programs.

7. Problems and outstanding issues

A. Budget margin

Although the new process has transformed the dynamics of preparing and deciding on the budget, it takes a while for bad old habits to die completely. And what Swedish politics traditionally has been made of is promising the electorate additional social benefits under the name of "reforms". However, with the ceiling effectively set three years earlier, the one seemingly remaining opportunity for politicians wanting to squeeze in yet one more "reform" has been to eat away at the budget margin. For that they have had to bet on being no unexpected cost increases in other areas. Unfortunately this has invariably proven to be an overly optimistic assumption and the price to be paid has been painful decisions and maneuverings at year-end to squeeze under the ceiling – and a concomitant loss of credibility.

B. Overall sector priorities

The top-down budgeting process, together with the increased focus on results, has created an opportunity for pondering, in a more thorough and systematic way, the overall composition of the budget. This opportunity has not really been seized.

It must, of course, be acknowledged that it is impossible to scientifically calculate and in any definitive way decide what would be the optimal sector allocation of government resources. There are too many imponderables, potential synergies and external effects for that ever to be conceivable.

It could still be argued that a lot more could be done in the way of analyzing the effectiveness and efficiency of programs – even at a more aggregate level – and seeing to it that the outcomes of those analytical endeavors are fed into the political process. For that to happen, the roles of the different actors in the budget process would need to be reviewed in order to achieve a clearer division of labor and responsibilities. One obstacle has previously also been the limited IT support for the budget process. That is now changing with the building up of an internet-based FMIS that will soon service all ministries and agencies. However, better IT support is a necessary but not a sufficient condition for a division of responsibilities better in keeping with the new top-approach. A cultural revolution and new capabilities will be needed at all levels within the Cabinet Office.

C. Long-term structural problems

The new multi-year top-down budget process has extended the budget horizon beyond the immediately coming year. It has not, however, automatically led to a systematic factoring in of the longer-term – beyond the three-year horizon of the expenditure ceilings. For Sweden, as for many other European countries, the fiscal perspective for the period beyond 2008 is quite problematic because of the aging population. Sweden does have a target for the budget balance that is higher than that of most other countries within the European Union. Still it is probably not ambitious enough to build the buffers that will be needed if the next generation is not to bear the

entire burden of the aging population. The problem is a specific and acute one for Sweden, but a generic one for all MTEF type efforts; in incorporating the medium-term into the budget process, one must not lose sight of the long-term!

The challenge is to create a framework for political decision-making that, just as the new top-down budgeting process in Sweden, conditions the outcome in favor of long-term collective rationality at the expense of short-term vested interests and vote maximization.

D. Technical issues

Global, hard budget constraints are essential to fiscal discipline; but it makes a difference how they are defined. There are several different dimensions to this issue.

For example, what should be the accounting basis for the constraints? In Sweden, the accounting basis for the volume constraint (to use a generic term for the expenditure ceiling) is the budgetary accounts, and they are expenditure-based. An alternative would be to base the volume constraint on the general accounts which are accrual-based. One important difference between the two sets of accounts is the treatment of investment. In the budgetary accounts, the full outlay for investments is included while in the accrual-based accounts only depreciation appears. The treatment of investment in the expenditure-based budgetary accounts means that, in relation to the global constraint, outlays for investments compete, krona for krona, with recurrent expenditure. One effect is that, in a tight fiscal situation, reductions in the budget are likely to focus on investment, simply because the government has more discretionary power over it.

A second important issue as regards the global volume ceiling is what should be included: total expenditure/cost for the entire general government or only central government? If the constraint should cover only central government, should it constrain total expenditure/cost or only that financed by central funds?⁹

Furthermore, should all types of expenditure/cost be included, or should some be excluded because the government has very little control over it in the short term? In the case of Sweden, interest payments on the central government debt are excluded. They were, with good reason excluded during the turbulent years of the 1990ies when interest rates were very volatile and even the slightest suspicion that the Swedish Government would default on its loans – for example because of putting interest payments under the ceiling – would have pushed interest rates even higher. In a more stable situation, like today, the choice is not quite as obvious. Interest payments are largely exogenous in the short term but in the medium and long term the Government can certainly influence them by through its debt policy. Including interest payments under the ceiling would increase the incentives to reduce debt for the benefit of future generations.

And then there are the funds outside the budget, like the pension fund. In Sweden they are included because payments in nature are very similar to regular government expenditure; they can be influenced by political decisions. In a funded system the Government would have no such right and it would be incorrect to include it.

As regards the budget balance, it is defined in national accounts terms. Having the two global constraints defined in different terms complicates matters technically and pedagogically. An alternative, given the existence of accrual-based accounts in the areas

⁹ A technical question in that respect is whether it is possible, in situations where central funds are pooled with other types of revenue, to attribute an expenditure/cost to a particular source of finance – at least in a credible way. And if one can not credibly follow it in the accounts, should one design a constraint that presumes just that?

for which the balance is calculated, would be to define it in straight accrual accounting terms. The balance thus calculated could then for comparative purposes – cf. the Maastricht criteria – be translated in into NR terms.

Sweden has, for good or bad, made a set of choices for how to define the aggregate ceilings. For any other country, the definitions would have to be based on an assessment what the ceilings should and could achieve and what the technical options for defining the ceilings are.