

Niklas Frank
Sweden

MTEF in Sweden (2)
The Swedish Budget Process : Expenditure
Targets and Top-down Decisions

Session 1-3 : International Experiences in MTEF
PRESENTERS

The Swedish Budget Process : Expenditure Targets and Top-down Decisions

by
Niklas Frank, Sweden

1. Background

In Sweden the Parliament is highly involved in the budget process. From a formal point of view the Parliament can change anything it wants in the budget. All the standing committees in Parliament, there are 16 all together, are involved in the process, and the responsibility for expenditure is divided between the various committees. The budget is split into 27 expenditure areas designed to reflect different areas of political interest, and the responsibility for the expenditure areas are divided between the committees according to their specialities. One committee may be responsible for one or more expenditure area but no expenditure area may be split between committees.

When the Government submits a bill to the Parliament, each Member of Parliament has the unrestricted right during 15 days to submit counter proposals, so-called motions. The motions are then distributed to the same committee that has been assigned the bill. Based on the bill and the motions, the committee then produces a report to the Chamber. This report contains the formal proposal on which the Parliament votes, as well as written argumentation about all the proposals. The committees must respond to every bill and every motion, none of them may be put aside. This applies also in the budget process. The Parliament subsequently has to process the Governments' budget documents as well as all the counter proposals that have been made by individual members.

Recession in the 90s led to the budget reform

The Swedish budget process was radically reformed in the middle of the 1990s, from a bottom up to a top down process. The starting point of the reforms was the deep economic recession that hit the country in the beginning of 90s. The environment in which the budget reforms took place was an environment of crisis.

In 1993 which was the worst year of the recession unemployment rose to 8 percent, a historically record high level. Growth in GDP was negative by 1,8 percent and the situation for the public finances was very serious. The Central Government borrowing requirement amounted to almost 17 percent of GDP and the overall deficit in the public sector was almost 12 percent of GDP. The deterioration of the public finances was great and very rapid. In the late 1980s Sweden had one of the largest surpluses in the OECD and only a few years later one of the largest deficits. By 1993 the national debt amounted to 76 percent of GDP, and was rising rapidly. Between 1988 and 1993 the public sector expenditure rose from 55 to 68 percent of GDP.

At the same time there were serious problems in the financial sector as well.

The Government had to spend about 4 percent of GDP to save banks from going bankrupt. In November 1992 the fixed exchange rate was abandoned for a freely floating rate, after the Central Bank had unsuccessfully tried to defend the fixed exchange rate by rising the short term interest rate to 500 percent. The value of the currency quickly dropped by about 25 percent.

To stabilise the public finances and lay foundations for an economic recovery, broad and radical measures were taken - both reductions in public expenditure and increases in taxes. There was also a broad political understanding that besides dealing with the immediate crises in the public finances, there was a need to find ways of preventing a similar situation from reoccurring in the future. In order to improve the long run stability of the public finances and prevent a repetition of the dramatic deterioration during the early 90s, the institutional arrangements around the budget were fundamentally changed.

The new budget process, which was in place in 1997, was stronger than the old process in virtually all respects. Changes were made in how the Government prepares the budget, in the way the Parliament considers and approves the budget as well as in the control and steering mechanisms on the implementation of the budget by the various Government agencies. The principles and rules for the budget were given a stronger legal status in the form of a budget law that was approved by the Parliament. According to a comparative study about the strength of the budget processes in a number of European countries, the Swedish process went from being one of the weakest in Europe, to being one the strongest, after the budget reform.

The reformed budget process enable the Parliament to take a more general and co-ordinated approach to the budget, focusing less on details and more on aggregates. The level of Central Government expenditure is determined three years ahead by setting an expenditure ceiling, and decisions on the budget are taken in two stages, the so-called framework model. The decision-making approach is top-down, starting with the whole and ending with the details. A surplus target for the whole public finances is being used.

In this presentation, I will focus on two elements of the new budget process, the two elements I regard as being the most important. First there is the use of two budgetary targets - the Central Government expenditure ceiling and the surplus target for the total public sector, and second there is the two-stage decision process in the Parliament.

2. Two budgetary targets, the expenditure ceiling and the surplus target.

A central element of the reformed budget process is the usage of quantitative budgetary targets. The Government has set up two such targets. There is a target stating that the expenditure of the Central Government budget must not exceed the expenditure ceiling that Parliament has decided upon. There is also a target for the financial balance in the total public sector, stating that as an average over a business cycle, there should be a surplus of two percent of GDP.

The two targets are different in their construction and use, and they should be regarded as complementary parts of an integrated budget system.

A. The structure of the budget

The expenditure side of the Central Government budget is divided into 27

expenditure areas, which are subdivided into around 500 appropriations all in all. The revenues are divided into about 150 revenue items.

Before the budget reforms there were a number of extra budgetary funds such as the unemployment benefit fund, the health insurance fund and the early retirement fund, to mention some. Expenditure from these funds amounted to a substantial part of the state expenditure but was formally not a part of the budget. Thus there was a significant discrepancy between the budget balance and the borrowing requirement. One of the changes in the budget reform was to abolish all such funds and bring all expenditure in to the budget. In the new system, the central Government budget deficit therefore equals the borrowing requirement.

Another change was to abolish the use of net budgeting. All expenditure and all revenue should be accounted for separately. This is an important principle that increases the transparency and openness of the budget, as well as it makes manipulation of the budget figures difficult.

B. The expenditure ceiling

The construction of the expenditure ceiling

The expenditure ceiling is a unique system that has no link to external demands or international standards. It is a voluntary restriction taken on by the Government. It should be pointed out that the budget law requires neither the Government nor the Parliament to use a ceiling for the expenditure, but it does stipulate rules on how such a ceiling should be handled if the Government should choose to use one.

In 1996 the expenditure ceiling was introduced. The system is based on a three-year budget cycle. In the autumn of year t , the Government proposes a level of the expenditure ceiling for the year $t+3$ to the Parliament. At the same time, the Government puts forward a proposal about the distribution of expenditure between the 27 expenditure areas for the year $t+1$, and a preliminary distribution for the years $t+2$ and $t+3$. The Government also presents the expenditure ceilings for the years $t+1$ and $t+2$, which have previously been decided by Parliament one and two years earlier. The Government is free to propose new levels for the ceilings even for the years $t+1$ and $t+2$, but in practice the Government has never done so. The only changes in previously decided ceilings have been of a technical nature due to changes that has not altered the budget balance.

The expenditure ceiling covers 26 of the 27 expenditure areas. The only expenditure area that is exempt is the interest on the national debt, which differs from other forms of expenditure in that it is less subject to control in the short run. In addition to the 26 expenditure areas, the ceiling covers the old-age pension scheme, even though this technically is not a part of the Central Government budget. Thus, the only public expenditure not included in the expenditure ceiling is the interest on the national debt and the expenditure of the Local Governments. (Concerning the 290 Local Governments in the country, there is a legal requirement that their budgets must balance each year. This means that all public expenditure is either subject to the expenditure ceiling or the Local Government balance requirement.)

Since it is difficult to assess expenditure changes three years ahead with a high degree of certainty, the expenditure ceiling is set at a level slightly above the estimated expenditure level. The difference between estimated expenditure and the ceiling is the so-called budget margin. This margin provides scope for meeting unforeseen increases in expenditure or for taking further spending decisions without exceeding the ceiling. However, use of the budget margin means that Central Government expenditure increases, and for the budget balance to be maintained there mu

st be matching increases in revenue.

The expenditure ceiling is stated in nominal terms, which means that the level set for each year of the three-year budget cycle is neither adjusted for inflation, nor indexed in any other way. The calculation of the ceiling is based on a macro-economic forecast that is presented in great detail in the budget documents. The inflation target of the central bank is to keep inflation at 2 percent (+/- 1 percentage point), and the macro-economic forecast for the budget is done in accordance with this target, assuming that the central bank meets its target.

The Parliament's decision on the expenditure ceiling is a so-called guideline decision, which means that it is not legally binding, and the Parliament is also able to review an earlier decision on an expenditure area. This could happen if there was a change of Government, in which case the incoming Government has the opportunity of submitting a proposal that differs from expenditure levels determined earlier. The expenditure ceiling should be regarded as a very strong budgetary commitment on the part of the sitting Government to implement a policy where aggregate Central Government expenditure (excluding interest on national debt) is kept within levels previously determined.

Expenditure ceilings and entitlements

The expenditure ceiling is, as mentioned before, set in nominal terms and includes all expenditure except interest on the national debt. Thus there is no kind of indexation in the ceiling and there are many expenditure items included even though they are highly sensitive to cyclical changes in the economy. This obviously means that there are potential tensions built in to the system. What if inflation increases so that the expenditures threaten to exceed the ceiling, even though the financial balance in the public sector is not worsened? What if the legal rights for individuals to receive entitlements exceed the limits set for the expenditure? Which is the stronger, the legal rights of the individual or the budget restrictions?

The Swedish attempt to solve these problems is strict on one hand and pragmatic on the other. When the ceiling is set it is crucial that there are credible forecasts on the economy as a whole, as well as on the individual expenditure items. In fact, one consequence of the new budget system has been to increase focus on the quality and reliability of the economic forecasts.

According to the budget law, if there is reason to believe that the ceiling might be exceeded, the Government is obliged to take measures to avoid this. At the same time, an individual may take a case to court to receive his or her legal entitlement.

In the short run, the right of the individual takes the upper hand. The Government can not deny an individual his legal entitlement by referring to the expenditure ceiling. The budget law does not state any legal consequences for a Government that violates it. In practice, the expenditure ceiling has never been exceeded, even though the margin to doing so has been very small a few times. The Government has taken measures by the end of the year to prevent the ceiling from being exceeded. What the consequences would be of exceeding the ceiling has therefore not yet been put to a real test, but surely there would be a political price for doing so.

If the expenditure forecasts indicate that the ceiling will be exceeded, for whatever reason, the Government has to address the problem. In order to keep the expenditure from exceeding the ceiling the Government must reduce some other expenditure, or in the medium term, consider the sustainability of the entitlement rules. The expenditure ceiling therefore works as a trigger for political considerations at an early stage, before expansion of expenditure has gone too far. The system thus makes it impossible for the Government to ignore or overlook a situation where the expenditure is about to exceed

the limits.

C. The surplus target

The surplus target is defined to include the three sectors that make up the entire public sector, the Central Government, the Local Governments and the Public Pension system. The target is specified in accordance with the European accounting system (European System of Accounts, ESA95) and numbers are comparable to the other EU-countries. This is also system used when evaluating the European stability pact to make sure that no country has a public sector deficit that exceeds -3 percent of GDP at any time.

The target stipulates that as an average over the business cycle, the over all public sector should show a surplus of two percent of GDP. For an individual year the surplus might, and should, deviate from the two percent depending on the current macroeconomic situation. Twice every year, the Government reports to the Parliament about the financial balance and presents three-year forecasts for the economy and the public sector financial balance.

The surplus target and the expenditure ceiling should be regarded as complementary targets. When the expenditure ceiling is set, it must be set in such a way that the surplus target is met, provided the estimated revenues. If revenues exceed the forecast those extra funds may not be used to increase expenditure more than is permitted by the expenditure ceiling. If revenues fall below the estimates then revenue either will have to be raised or expenditure cut in order to maintain the surplus target. Together the two targets provide a strong framework for the budget formulation.

3. The framework model

The decision process in the Parliament is called the framework model. It is a process designed for top down decision making. First, limits are set on an aggregate level and then the details are decided, under the aggregated restrictions. The process revolves around two annual bills, the Spring Fiscal Policy Bill and the Budget Bill. The Parliamentary decisions on the Budget Bill are taken in two distinct stages during the autumn, leading up to the start of the fiscal year.

A. The Spring Bill

The budget process in the Parliament begins when the Government submits its Spring Fiscal Policy Bill. The bill, which must be submitted no later than April 15, contains an assessment of the current economic situation with perspectives for the next three years and proposals for the orientation of the economic policy and the budget policy.

In the Spring Bill there are no formal proposals from the Government involving precise numbers. The bill contains detailed medium term forecasts for the macro economy, the Central Government expenditure and revenue, and the overall public finances. In the bill the Government presents the expenditure for the coming three years on expenditure area level, divided in to the 27 different areas. At this stage the Government presents a calculation of the year t+3 to the Parliament for the first time. Calculations of revenue are also presented in a relatively high level of detail.

The Spring Bill is thus used to give Parliament a rather detailed picture of the economy as well as the budgetary situation. There must however be neither tax proposals,

nor proposals concerning the expenditure at this stage. The detailed presentation of the budget gives the Parliament information about what the Government intends to propose later in the Budget Bill, due in September.

As with all Government bills, the members of Parliament have 15 days to write their counter proposals, their motions. In the case of the Spring Bill, the opposition parties, currently four, present their alternative views on the economic situation and their alternative suggestions regarding guidelines for the economic policy and the budget policy. In this process the special committees in Parliament may submit their opinions about the Government bill, as well as about the oppositions proposals, to the Committee on Finance

The Spring Bill, the proposals from the opposition and the opinions from other committees, are all submitted to the Committee on Finance, which writes a report to the Chamber where the political alternatives are presented. In the middle of June a formal decision is taken about the guidelines for the economic policy and the budget policy.

B. The Budget Bill

The Government submits its Budget Bill for the following year by September 20 at the latest, a few days after the opening of the parliamentary session. During election years the submission period may be extended, but no later than November 15. The Budget Bill covers all expenditure and revenue, since no further proposals with budgetary consequences may be submitted before the beginning of the fiscal year. The gross principle is applied in that all revenue and expenditure are accounted for separately.

All intended changes for the coming year in revenues and expenditure must be presented to the Parliament in the Budget Bill. The estimates of expenditure as well as revenue must include all the proposed changes. There must be no last minute changes of taxes or expenditure after the presentation of the Budget Bill.

The expenditure is presented with its 27 expenditure areas and 500 appropriations, and the revenue is presented with its 150 items. The opposition parties present their alternative proposals to those of the Government. Usually the opposition parties provide an overall presentation of their budget alternatives in special motions on economic policy. In this context they present their proposals for the expenditure ceiling and for the allocation of expenditure between the expenditure areas. In their motions on economic policy the parties also present an overview of the changes in taxes and charges they wish to implement, and how proposals for different reforms should be financed.

A more detailed specification of the various parties' budgetary proposals is set out in special tax and appropriations motions, where the parties usually present their proposals in the form of one motion per expenditure area.

The Budget decision, stage one

The decision-making procedure that the Parliament uses when considering the Budget Bill is known as the framework model. This means that the Parliament first takes a decision on the overall size of the budget, i.e. total Central Government expenditure and how this should be allocated between the 27 expenditure areas. By means of this decision, expenditure is fixed and the level determined for each expenditure area, the so-called expenditure area frames. Thereafter these frames function as limits which may not be exceeded in the second stage, when the Parliament finalises the budget.

In the first decision the Parliament also determines changes in the taxes and c

charges for the next fiscal year. This enables the level of Central Government revenue for the following year to be estimated. For obvious reasons, it is not possible to determine limits for revenue in the same way as for expenditure. This is why the Parliament does not make a decision on revenue limits. Revenues are determined by how the tax base changes, which itself is related to changes in the economy, and the rules applicable to taxes and charges. These rules apply until they are changed or removed and are not considered by the Parliament each year when determining the budget. The budget proposal can, however, contain proposals for changes in the regulatory framework covering e.g. tax changes. The Parliament approves an estimate of the Central Government revenues during the coming fiscal year, and at the same time decides which changes in taxes and charges are to be implemented. Since the levels of revenue and expenditure are thus determined, the level of borrowing requirements can also be stated.

The Committee on Finance handles proposals on the frames for all the expenditure areas. The other committees may submit their views to the Committee on Finance on the expenditure areas for which they are responsible. The committees are free to propose changes in the level of the different expenditure areas and/or recommend a reallocation of funds between expenditure areas. In the same way, they can make proposals that affect the level of Central Government revenue.

The Committee on Finance then examines these proposals and uses them as a basis for submitting an overall proposal that will be considered by the Chamber around November 20. The debate in the Chamber concludes with the Parliament making one single decision determining several important elements simultaneously. The main elements of the decision are:

- The overall expenditure ceiling for the year $t+3$
- Expenditure ceilings for the years $t+1$ and $t+2$, in case they are being changed
- The allocation of expenditure between the 27 areas for the year $t+1$
- All proposed changes in taxes and charges for the year $t+1$
- Approval of an estimation of total revenue for the year $t+1$

The fact that all these points are decided by Parliament in one single decision, is not a mere technicality, but is of crucial importance to the top-down character of the budget process. The Committee on Finance decides the distribution of expenditure between the expenditure areas, in a single decision. Thus any Parliamentary changes in the Governments' suggested distribution can only be done by the Committee on Finance in this first stage of the decision process. This single decision system has at least two important implications for the budget process.

Firstly, it sets a restriction on what the special committees can do in the second stage of the process. The special committees are responsible for the distribution of expenditure appropriations within their respective expenditure areas, but they have to keep expenditure inside the expenditure area frame set in the first stage. A special committee can therefore not expand the expenditure in its own area even if there is a majority in that committee to do so. The room for manoeuvre in the special committees is therefore highly restricted.

Secondly, it forces the opposition parties to present complete budget alternatives instead of only picking the pieces they prefer to discuss. To present a feasible alternative to the Governments budget proposal, the opposition has to present an alternative decision including all its tax changes and its distribution of expenditure between the 27 expenditure areas. All expenditure limits and tax changes are treated

d as a single “package”, and alternatives are considered against each other as single “packages”. The Parliament then takes a position on the entire package. This means that even if the opposition parties agree on an issue, they cannot form a majority on this issue alone and use this to reject a part of the Government proposal.

To defeat the Government in the parliamentary vote, the opposition must agree on an entire budget package.

This budget decision is probably the single most important decision that the Parliament takes during the year. If the opposition would actually win this vote there would be a Government crisis. Without support for its budget policy the Government might have to resign, or there would most likely be at least a vote of no confidence.

With this package decision, six weeks before the start of the year t+1, the Parliament sets the expenditure limits and concludes its revenue deliberations and determines the tax regulations that will be in force in the coming year. Still remaining is the more detailed allocation of Central Government expenditure. This is dealt with during the second stage of the budget process.

The Budget decision, stage two

In the second stage of the budget process, the 15 various special committees handle their respective expenditure areas. The special committees put forward proposals on the goals of the activities and the allocation of funds in their expenditure areas. The whole expenditure area is treated in a single report and the Parliament makes a decision on the appropriations and their distribution within the total expenditure area by means of one single decision.

This is a parallel to the decision of the distribution between expenditure areas in the first stage, and the implication for the opposition parties is the same. It is not possible to single out individual items within an expenditure area, and increase expenditure for those items. In order to change the distribution within the expenditure area the opposition parties must agree on all appropriations in that area. An increase in one expenditure appropriation must therefore be financed by a decrease of another appropriation in the same area. Any other way of financing the new expenditure is closed. A special committee that is responsible for more than one expenditure area may not reallocate expenditure between those areas. The decision on the frames in stage one applies for each expenditure area regardless of which special committee that has the responsibility in the second stage.

The committee may not put forward any proposals that would lead to the previously determined limits from stage one being exceeded. If a committee wishes to take an initiative of its own, or act on a private member’s motion, the financial effects must be taken into account. Such proposals must be financed by an equivalent reduction elsewhere within the same expenditure area. It is not even permissible for dissenting opinions to propose a limit higher than previously decided on by the Parliament in the first stage.

Should a committee consider that an expenditure frame ought to be expanded, for instance, on the grounds that there has been a change in some underlying variable, this can only take place if the Parliament - on a proposal from the Committee on Finance - decides so. In such a situation, the Committee on Finance may consider whether the limit for other expenditure areas should be reduced. The aim of this procedure is that the Committee on Finance and the Parliament should also consider how the proposed increase in expenditure is to be financed.

Each special committee writes a report on their respective expenditure areas and these are finalised in the beginning of December. After the debates in the Cha

member, decisions are taken on the various appropriations for the coming year. When this has been done, the Government issues budget letters to its agencies with instructions for how the appropriations are to be used.

When all the reports have been dealt with, the Parliament compiles the now finalised Central Government budget for the coming year and hands it over to the Government a few days before Christmas.

4. Effects of the reformed budget process

The changes in the budget process have had a number of consequences and I will mention the most important ones.

It has moved focus towards the medium term perspective

One important element in the budget process is the setting of a nominal expenditure ceiling for the year $t+3$. This has made it necessary for the Government to make a detailed macroeconomic forecast as well as detailed expenditure and revenue forecasts for three years to come. This in turn has put pressure on the Government to improve its forecasting methods. The requirement for the Government to act in case the expenditure ceiling is threatened has moved increasing public expenditure higher on the political agenda. With the reformed budget system, budgetary problems need to be identified and dealt with in a relatively early stage.

A. It has put a minority Government in a strong position

Sweden has a proportional electoral system. The representation of the different political parties in Parliament is strictly proportional to that of the popular vote, limited only by a 4 percent minimum requirement of the votes to get seats in Parliament. Without going in to details about different electoral systems, it is a well-established conclusion that proportional systems have a tendency to produce weaker Governments than systems based on majority voting. Sweden has a long history of either Minority Governments depending on the additional support in Parliament of at least one more party, or coalition Governments with up to four co-operating parties. Strengthening the position of a Minority Government was therefore a desired effect of the budget reform.

In order for the opposition to overthrow the Government's budget proposal, it has to agree on a complete alternative. It is not possible for the opposition to agree on certain items and change the Government's bill on those items only. Obviously, agreeing on the entire budget is politically much more difficult than agreeing on individual issues. With the reformed system, a Government that has a relative majority has a strong position in the parliamentary budget process. In this way you might say that the reformation of the budget process has moved power from the Parliament to the Government.

B. It has strengthened the Committee on Finance

The two stage decision model has given the Committee on Finance the overall responsibility for the budget in the Parliament. The Committee on Finance has been given the power to restrict the other committees' possibilities of spending resources in their own areas. Giving this power to the Committee on Finance has been an important element in creating a top-down structure of the process. The overall expenditure ceiling and the distribution between expenditure areas are decided first, setting the limits for the appropriations in the different expenditure areas. Provided that the expenditure area

frames are not exceeded, the special committees however still have great freedom to redistribute the expenditure within their respective expenditure areas.

C. It has increased the transparency of the budget process

Transparency has improved in several ways. The budget has been made complete and extra budgetary funds abolished. Revenue and expenditure are accounted for separately and net budgeting is not permitted. The need for the opposition to present complete budget proposals has made the political alternatives more open and comparable. It is no longer possible for an opposition party to present for instance large increases in benefits without declaring how it will be financed.

5. Criticism and problems in the budget process

Even though there has been a high degree of political consensus surrounding the reformation of the budget process, there has been criticism and some changes have been made.

A. The budget process takes all year

One criticism from the Parliament has been that the budget process takes all year. Producing a complete budget alternative is a great deal of work for the opposition parties, particularly for a small party with limited resources. This aspect led to a change in the system in 2002. Before then the formal proposal on the over all expenditure ceiling was a part of the Spring Bill. The Spring Bill then contained guidelines for the economic policy and for the budget policy as well as an expenditure ceiling for the year $t+3$. In 2002 this was changed so that the ceiling for $t+3$ is proposed in the Budget Bill in September. This was a controversial change decided by a united opposition against the will of the Government, who argued that the change would weaken the budget process.

B. The budget margin too small

When the system was launched, there was a guideline about the size of the budget margin saying that the margin should be approximately 1,5; 2,0 and 2,5 percent of the total expenditure for the years $t+1$ to $t+3$. As uncertainty about the numbers grew over time, so would the budget margin. In practice however, this margin has not been upheld. Instead there has been a tendency to use the margin for new expenditure, stretching the ceiling as far as possible. Several times the Government has had to take short-term measures in the end of the year to avoid the expenditure ceiling being exceeded. This has had a tendency to shift focus back again from the medium term to the short term, at least in the end of the fiscal year.

This problem has been discussed extensively as the Government has been criticised for its handling of the budget margin. The Government has been requested by the Parliament to present new guidelines about the size and use of the budget margin in the Spring Bill in April this year.

C. Technical measures to avoid the expenditure ceiling

The lack of margin to the ceiling at the end of the year has led to short term measures to avoid exceeding the ceiling. At times such measures have been dubious from the

perspective of the budget law. The Government has for instance decided to delay expenditure from December to January and there are examples where net budgeting has been applied even though the budget law prohibits it. These short-term measures are obviously closely related to the problem of having a too small budget margin.

6. Concluding reflections

Both the Government and the Parliament have made evaluations of the budget process, and both have concluded that the reformation has been very successful. The two evaluations have pointed out the problems mentioned above, but put in perspective of all the changes that were made, these problems must be considered limited. There can be no doubt that the new process is far stricter than the old, since it was strengthened in practically every respect and transformed from one of the weakest to one of the strongest in Europe.

How important is the budget process to the outcome of the budget policy? Would the budgetary situation look different if the budget reform had never taken place? Concerning this, there are a few observations that can be made. The far-reaching decisions that were taken in the middle of the 1990s to strengthen the public finances were all taken before the reformation of the budget process. In the rather critical situation of 1993 there was a great need to strengthen the budget and no time to wait. When the political will was strong enough, drastic measures could be taken even without a strong budget process.

After the immediate crises, during the years in the late 90s the economy was performing relatively well. Between 1998 to 2000, the economy grew faster than the European average. Tax revenues were exceeding the forecasts and there was a substantial surplus in the total public sector. At the same time the expenditure ceiling was set so that expenditure were reduced as a share of GDP. Between 1997 and 2000 the expenditure ceiling was reduced from 38 to 34 percent of GDP. Since then the ceiling has been stable. I believe there is a rather strong case for the claim that the reformation of the budget process has contributed to the stable development of the public finances since the middle of the 1990s. A lot of political prestige has been invested in the new system, both by the Government and the opposition, and the potential political risks of ruining or undermining the system are considerable. During this period there has been a Social Democratic minority Government that has negotiated the budget with either one or two other parties, and the respect for the expenditure ceiling has been a cornerstone all through those negotiations. As mentioned above, the budget margins have become very small at times, but measures have been taken to stop the ceiling from being exceeded. It is not a very brave guess that without the ceiling, the negotiations would have generated significantly higher expenditures.

It should be added though, that the real test for the system is yet to come. During the boom years of the late 90s the surplus target for the public sector could be upheld with relative ease thanks to the high levels of tax revenue. There was even room to fulfil the surplus target and cut taxes at the same time. The last few years however, have shown a less favourable macro economic development. This has led to weaker growth in tax revenues and increases in expenditure mostly related to health insurance and unemployment. For the first time since the new budget system was put in place, there is now simultaneous pressure on both budgetary targets, and the macro economic situation is not helping to ease the pressure.

It is crucial to keep in mind, even though it may seem self-evident, that in the long run no budget process is stronger than the political will to maintain it. There is a delicate balance between a system strict enough to have substantial influence on the budget

policy, and loose enough to provide the necessary room for political manoeuvre