# Sweden: Watchdog with a Broad Remit

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## 1 Introduction

Institutions with fiscal watchdog tasks have existed for a long time in some countries: Belgium, Denmark, the Netherlands and the US are prominent examples. Recently, such institutions have been established in several other countries as well.[1] One of the first cases in this "second wave" was the *Fiscal Policy Council* (FPC) in Sweden, which was created in 2007. It appears to have served as a source of inspiration for similar bodies established elsewhere, including in Ireland, Portugal, Slovenia and the UK. This chapter describes the Swedish Council and analyses its experiences.

The chapter is structured as follows. Section 2 gives the background. Section 3 describes the Council's structure and remit. Section 4 gives an account of its work. Section 5 discusses how a number of issues of principles have been handled and what the Swedish experiences can teach us in these respects. Section 6 concludes.

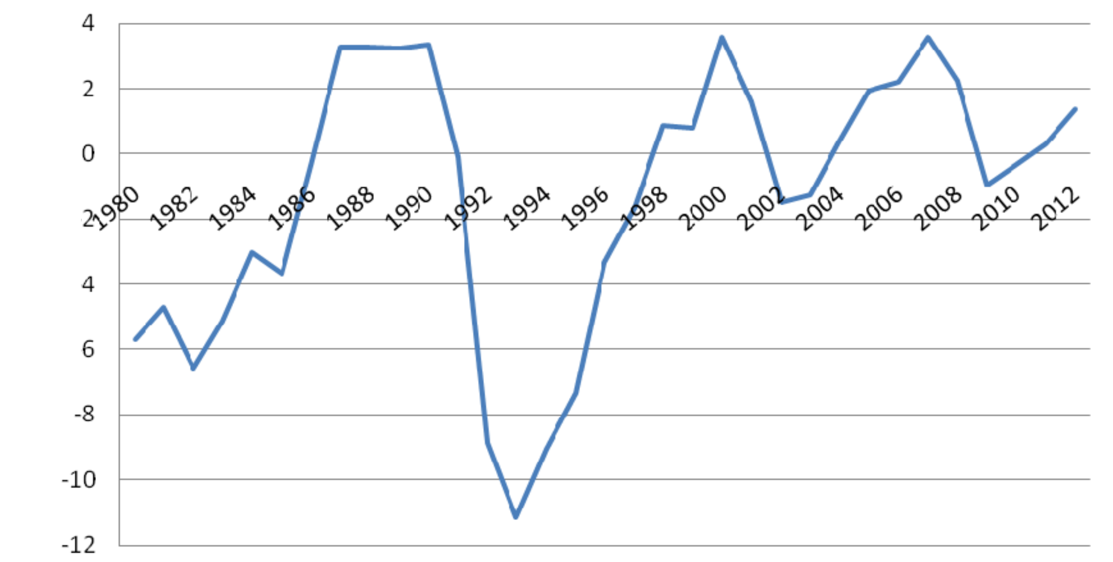
## 2 Background

### 2.1 The fiscal framework in Sweden

In the early 1990's, the Swedish economy suffered a deep crisis, with great similarities to the recent crises in Ireland and Spain. GDP fell for three consecutive years 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 government gross debt rose from 41.2 per cent of GDP in 1990 to 73.3 per cent in 1996. In 1994-95 there were interest rate differentials for ten-year government bonds to Germany of 3-4 percentage points (see Figure 3).

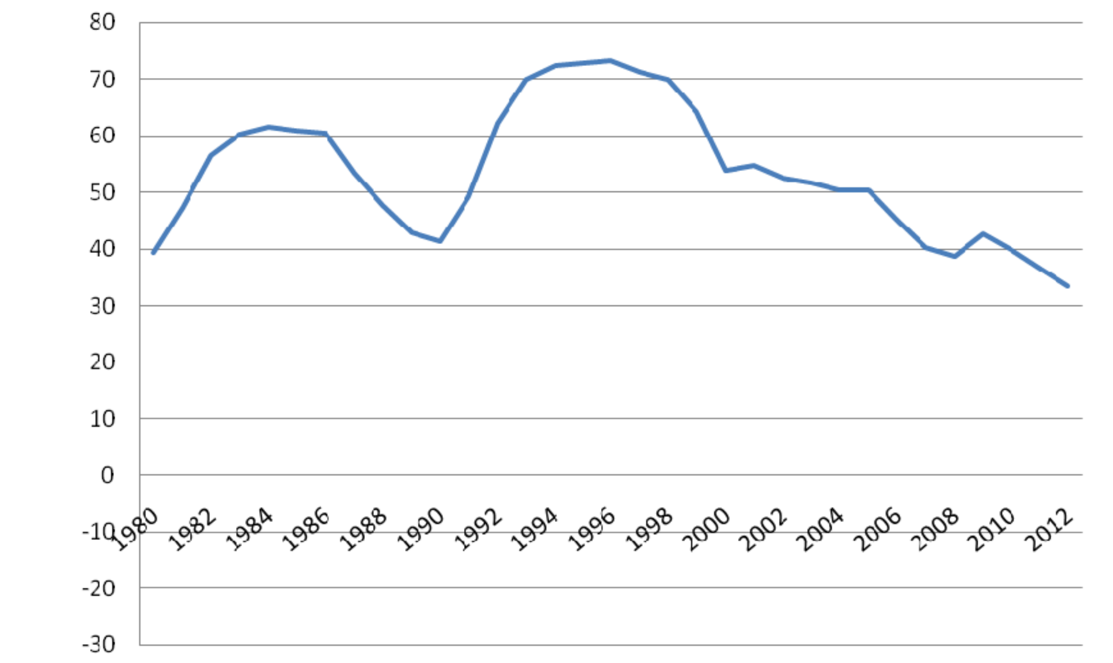
[1] Calmfors and Wren-Lewis (2011) survey both earlier existing and recently established fiscal watchdogs. See also Calmfors (2010) and Hagemann (2010).

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



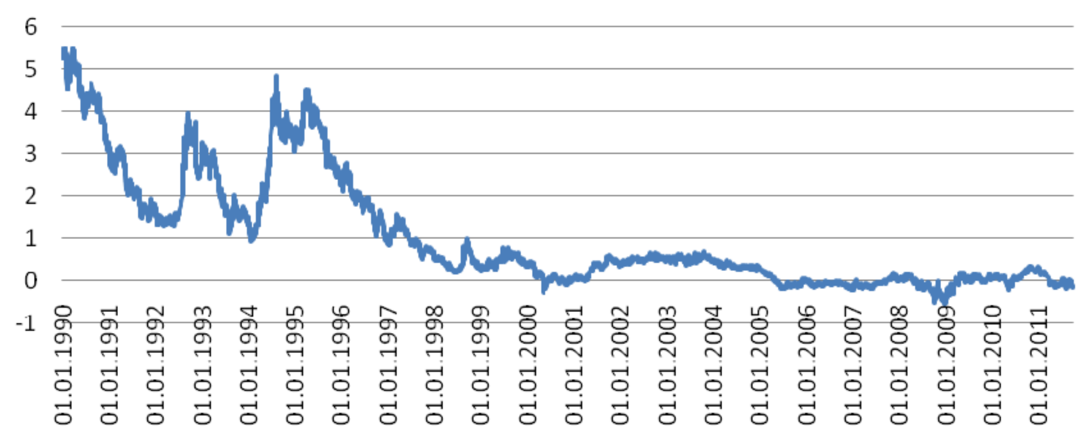

*Source:* OECD Economic Outlook No. 89.

**Figure 2 Consolidated government gross debt in Sweden, per cent of GDP**




*Note:* Consolidated government gross debt (Maastricht debt) is defined as the general government total debt after internal claims and liabilities in the sector have been netted out.
*Source:* Ameco.

**Figure 3 Interest rate differential between Sweden and Germany on ten-year government bonds**




*Source:* Reuters EcoWin.

The fiscal crisis triggered an ambitious budget consolidation programme. It built on clearly defined budget targets setting out an *unconditional* plan for reductions of the deficits that was to be reached independently of cyclical developments. The plan was carried out successfully.[2] In 2000, the budget deficit had been turned into a surplus of 3.6 per cent of GDP.

The crisis also led to the adoption of a new fiscal framework to prevent fiscal crises from arising in the future. The framework is still in place. It has five central pillars:[3]

- 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 expenditure without cutting down other expenditures within the same area.
- A *surplus target* for general government net lending of one per cent of GDP over a business cycle.

[2] See Henriksson (2007) for an account of the budget consolidation process.
[3] More detailed descriptions of the fiscal framework are given in, for example, Fiscal Policy Council (2010, 2011) and Spring Fiscal Policy Bill (2010, 2011).

- A *ceiling for central government expenditures*, which is determined three years in advance.
- A *balanced budget requirement for local governments*.
- A *reformed pension system* with *defined contributions* and an automatic balancing mechanism that is to guarantee the system's long-run sustainability.

The rules put in place have largely been followed. As a result, average government net lending in 2000-2010 amounted to 0.8 per cent of GDP despite the unusually deep recent downturn. The surpluses in 2007 and 2008 were as large as 3.6 and 2.2 per cent of GDP, respectively. The deficit at the trough of the recession in 2009 was as small as 0.9 per cent of GDP and in 2010-2011 net lending was close to zero. The most problematic rule has been the expenditure ceiling. Although it has never been formally violated, it has been circumvented (although only marginally) several times through the use of tax expenditures and manipulations of the timing of payments.[4]

### 2.2 The establishment of the FPC

Changes in fiscal policy institutions may occur as a response to either acute problems or to theoretical considerations regarding future potential problems. In the Swedish case, the latter type of response explains the establishment of the FPC.

The idea of a fiscal watchdog in Sweden was first raised in connection with the debate on whether or not to 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 analysed 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 once the country had relinquished its own monetary policy. The Commission worried that fiscal policy would be too lax in booms, leaving no room for stimulus in downturns. To counter that risk, the establishment of an independent fiscal council, which would give the government authoritative policy recommendations, was proposed.[5]

[4] See the Spring Fiscal Policy Bill (2007) and Fiscal Policy Council (2009, 2011).
[5] Swedish Government Commission on Stabilisation Policy in EMU (2002).

The idea of a council did not come down well with the Social Democratic government at the time, which explicitly opposed this proposal as well as similar other proposals.[6] However, the idea was received more positively by the liberal-conservative opposition. In 2003, the then chief economist of the Moderates (the Swedish Tory Party), Anders Borg, wrote an article where he came out in favour of an advisory fiscal council.[7]

In 2006, a liberal-conservative government took office, with Anders Borg as Minister for Finance. He pushed the idea and in the spring 2007 the establishment of the Fiscal Policy Council was decided. There was, however, political disagreement. All the opposition parties – the Social Democrats, the Left and the Greens – voted against the creation 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".[8]

Empirical studies of fiscal rules and fiscal transparency usually find that both contribute to stronger budget outcomes.[9] A well-known problem is, however, the difficulty of establishing whether these factors *cause* the budget outcomes or whether both they and the budget outcomes are *caused* by the same third factor(s). These considerations are highly relevant for Sweden. *Both* the recent favourable fiscal performance *and* the establishment of the Council can be seen as consequences of a strong striving to safeguard public finances, which in turn is explained by the experiences of fiscal crisis in the early 1990's. This does not, of course, imply that the Council may not have an additional effect on fiscal policy over and above that of the political consensus on budget discipline.

## 3 The Council's structure and remit[10]

The FPC is formally an agency under the Government, which appoints the six members. Ordinary members can be appointed for a maximum period of three consecutive years.

[6] See, for example, Calmfors (1999, 2001, 2002, 2005).
[7] Borg (2003).
[8] Motion 2006/07:Fi7.
[9] See, for example, Alt and Lassen (2006), Fabrizio and Mody (2006), European Commission (2006), IMF (2009) and Lassen (2010).
[10] This section describes the Council's statutes. They can be found in *Förordning* (2011:446), which replaced the earlier *Förordning* (2007:760).

The Chair can be appointed for at most two consecutive three-year periods. The Council is to consist of both members “with high scientific competence in economics” and members “with practical experience of economic-policy work”. In November 2011, the Council is made up of five academic economists (but of whom the Chair, Professor Lars Jonung, also has practical experience from the Prime Minister’s Office in the early 1990’s and later from the European Commission) and one former civil servant (with work experience as Budget Director in the Ministry of Finance and later as one of three heads of the National Audit Office). The members need not be Swedes: currently there is one Norwegian member.[11] The members perform their duties as supplementary activities to their ordinary work. There is a small secretariat consisting of five persons.

The FPC has a *broad remit*. According to the statutes in force from 1 July 2011, it is “to monitor and evaluate the fullfillment of objectives by the fiscal policy and the economic policy which the Government proposes and the Parliament decides and in this way contribute to more transparency regarding the aims and effectiveness of economic policy”. On the basis of the Spring Fiscal Policy Bill and the Budget Bill, the Council is in particular to evaluate if fiscal policy is consistent with (1) public finances that are sustainable in the long run; and (2) the budget targets, especially the surplus target and the expenditure ceiling.

The Council is also (1) to evaluate how the fiscal stance relates to the cyclical situation; (2) to evaluate if fiscal policy is in line with healthy, sustainable long-run growth and leads to high employment which is sustainable in the long run; (3) to monitor the transparency of the Spring Fiscal Policy Bill and the Budget Bill, in particular with respect to the grounds given for economic policy as well as the motives for policy proposals; and (4) to analyse fiscal policy’s effects on the distribution of welfare in the short run and the long run. In addition, “the Council may monitor and evaluate the quality of the Government’s forecasts and the models on which the forecasts are based”.

The cited formulations make it clear that the Council’s remit goes far beyond fiscal sustainability and budget discipline. It also includes the role of fiscal policy as a stabilisation tool as well as employment and growth policies. An important part of the

[11] In 2007-2011 there were eight members, of whom six were academics and two were ex-politicians (one former Social Democratic Minister for Finance and one former Vice Chair of the Moderates). One member was Danish and another one Finnish.

remit is to contribute to 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 emphasised by the formulation in the statutes that the Council "should work to achieve an increased public discussion in society of economic policy".

The statutes are vague on whether evaluations should only be *ex post* or whether they can also be *ex ante*. This has been left to the Council to decide. It has made the interpretation that evaluations should be both *ex post* and *ex ante*. Hence, in addition to evaluating past policies the Council comments on new government proposals and sometimes makes alternative suggestions.

The only formal requirement is that the Council 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 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 regularly a public hearing on the basis of the report with participation of the Council's Chair, the Minister for Finance and outside experts.

## 4 The Council's work

So far (in November 2011) the FPC has produced four annual reports. In addition, 26 background reports commissioned from either outside academics (both Swedish and foreign) or written by the Council's own members have been published. Several shorter opinions on various Government proposals have also been written.

### 4.1 Themes in the reports

On the whole, the Council's evaluations of the Government's fiscal policy have been very favourable. It has been judged to be sustainable in the long run and consistent with the budget targets. There have been mainly two points of disagreement with the Government: the first concerns *potential* problems deriving from ambiguities in the fiscal framework, the second the room for fiscal stimulus in the 2009-2010 downturn.

*Ambiguities in the fiscal framework*

When the surplus target of one per cent of GDP was decided in 1997, no clear justification was given for the level chosen. Later Government Bills have made it clear that the target should be seen as an *intermediate* one which should help achieving more fundamental objectives: fair intergenerational distribution, social efficiency (tax smoothing), and the build-up of a precautionary buffer to be used in the event of unanticipated macroeconomic shocks. However, the Government has not specified the relative weights of the different underlying motives, which should be necessary to decide the appropriate level of the target. The Council has urged the Government to provide better underpinnings for the chosen level and to link it better to long-run fiscal sustainability calculations.

A related issue concerns the interpretation of the formulation "a surplus of one per cent of GDP *over a business cycle*". The Government uses five different indicators of its net lending to judge whether this is achieved: a backward-looking ten-year average, a forward-looking seven-year moving average centred on the current year, current structural net lending, a backward-looking ten-year average of cyclically adjusted net lending (which is defined differently from structural net lending), and a forward-looking seven-year moving average of cyclically adjusted net lending. According to the Council, the many indicators could create confusion since they may show very different results. More fundamentally, the surplus target has 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 compensation for deviations).[12] The Council has argued in favour of fewer indicators and a clear stand on how the target should be interpreted.

*The fiscal stance*

In 2010 before the parliamentary elections, the FPC warned both the Government and the opposition that the fiscal room for tax cuts and expenditure increases was very small. In its 2011 report, the Council highlighted the conflicts between the surplus target, the level

[12] See in particular Fiscal Policy Council (2009, 2010).

of the expenditure ceiling and the Government's plans for tax cuts: in the Council's view the expenditure increases allowed by the ceiling and the planned tax cuts threatened the achievement of the surplus target. Therefore, the Council urged the Government either to lower the expenditure ceiling or to abstain from the planned tax cuts.

The greatest policy disagreement between the Council and the Government has concerned the fiscal stance in the 2009-2010 recession.[13] Notably, the Council recommended *more* stimulus than the Government thought appropriate. In the Council's view, the Government overestimated both the risks of adverse financial-market reactions to a more expansionary fiscal stance (given the strong public finances in Sweden) and the strength of the automatic stabilisers.

*Employment and growth*

The current government has tried to raise employment through sweeping labour market reforms. They have entailed cuts in unemployment benefits and the introduction of an earned income tax credit. The reforms have been politically very controversial, with the opposition parties arguing strongly against them and questioning their effectiveness.

Here, the Council has evaluated the research basis for the reforms. The conclusions have been that the reforms are likely to have substantial positive employment effects in the long term. At the same time, the Council has criticised the Government for not explaining that the reforms will promote job creation largely by inducing wage restraint.

The Council has also been critical of how the tax system has developed. In 1990/91 there was a comprehensive tax reform, broadening tax bases and imposing principles of uniformity and neutrality. But these principles have gradually been abandoned through the introduction of a number of exceptions: different VAT rates for different types of consumption, selective cuts of employer contributions for young people, abolishment of the property tax, RMI tax deductions etc. The Council has analysed which changes can be motivated by either optimal taxation arguments or income distribution concerns and which are hard to find such arguments for.

*Economic reporting*

[13] Fiscal Policy Council (2009, 2011). See also Section 5.1 below.

The Council has had critical views on parts of the Government's economic reporting. These criticisms have concerned the lack of reporting of the public sector's *total* net worth (in contrast to the careful reporting of *financial* net worth), very rudimentary reporting of government investment and of the development of the government real capital stock, and insufficient reporting of the size and contents of various labour market programmes.

**4.2 The Council's impact**

It is not obvious how to evaluate the Council's impact. One should distinguish between, on one hand, the direct short-term impact on the Government's actions and, on the other hand, the indirect long-term impact through influence on general thinking about economic policy. The former impact is more tangible, but the latter may in the end prove more important. Three "metrics" are used here: (1) media coverage (which is 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 annual reports, which are presented at press conferences. They have been covered by the main TV and radio channels. The presentation of the report has also received broad coverage in news articles and editorials in both national and local newspapers. The public hearings in the Parliament's Finance Committee on the report have been broadcast live in one of the state TV channels.

More importantly, there has been a steady stream over the year of articles, editorials and op-eds in the press that use the FPC's report as a point of reference. 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 in addition to the spikes when the annual report is published.

There has been a large number of interviews in various media of the FPC's members (and in particular of the Chair) spread over the year on various issues of fiscal and employment policy. Council members are to a large extent turned to when journalists want independent comments on both domestic and foreign (especially EU) macroeconomic issues. The views of Council members have on these occasions often been contrasted with the views of the Minister for Finance and the Government.

*Reactions from the political system*

Both the Minister for Finance and the economic spokespersons of the political parties have issued statements on the report when it is published. When the Parliament's Finance Committee evaluates the Government's Spring Fiscal Policy Bill, the Council's views are extensively reported and commented upon.

In the Government's Budget Bill, presented to the Parliament in the autumn, one section summarises the FPC's report and takes a stand on its recommendations. There have also been frequent references to the Council's analyses in both the opposition parties' economic proposals and in the comments by MPs from the various political parties in the parliamentary debates.

*Impact on Government policy and analysis*

It is difficult to evaluate the Council's impact on actual policy, since this presumes knowledge about the counterfactual. It is not possible to conclude to what extent Government proposals have been affected *ex ante* by a possible desire to avoid potential *ex post* criticism from the Council. One cannot, of course, expect the Government to back from proposals already made to the Parliament, as this would usually imply a large loss of political prestige.

One case where the Council had an influence concerns the amount of fiscal stimulus in 2009-10. Here, the Government in the end followed the recommendation by the FPC (and by others such as the National Institute for Economic Researach) to give *temporary* extra grants to local governments.[14] The Council's call to all the political parties before the 2010 parliamentary elections to avoid committing to measures that would permanently worsen the budget balance is also likely to have had an influence. The warnings in the 2011 report that the Government's planned tax cuts implied risks for

[14] Swedish Fiscal Policy Council (2009). See also Section 4.1.

budget discipline may have contributed to the shelving of these plans (although the worsening economic outlook and a likely defeat in the vote in the Parliament were more important reasons).

The FPC has definitely had an impact on the Government's thinking on the surplus target. Here, a thorough review made by the Ministry of Finance was heavily influenced by the Council's analyses.[15] The review made 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.[16] A key conclusion drawn by the Government – and in line with the FPC's recommendation – is that future demographic strains on public finances from longer life expectancy should be met by increases in the retirement age rather than through pre-funding (that is by saving in advance through fiscal surpluses). The argument is that it is not reasonable that current generations fund costs associated with the welfare gains for future generations following from increased longevity.

At a more technical level, the Council has come up with a number of suggestions on how the Government's fiscal sustainability calculations and their presentation can be improved. These suggestions have largely been followed. After the FPC's critique, the Government has improved its reporting of total public sector net worth and public sector capital stock, although only to a limited extent. The Government has repeatedly promised to improve its reporting of government investment, but has so far not delivered on this.

A key area where the Council was not able to influence policy concerns creative accounting with respect to the expenditure ceiling. The extra central government grants to local governments for 2010 were paid out in December 2009 to reduce the risk that the expenditure ceiling would be breached in 2010 (in 2009 there was no risk this would happen). Here, the Government just swept aside the Council's critique.

## 5 Lessons from Sweden

The Swedish example illustrates several problems of general interest for the structure and work of fiscal councils. The following issues will be discussed:

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[15] Finansdepartementet (2010).
[16] See Section 4.1 above.

1. The breadth of the remit.
2. The amount of resources and the tasks performed.
3. The Council in the general political debate.
4. The Council's independence.
5. The political fragility of the Council.

**5.1 How broad should the remit be?**

The FPC's remit is much broader than according to most proposals on such councils.[17] As discussed in Section 3.2, the remit does not only encompass evaluation of fiscal policy but also analysis of employment, growth and income distribution. This is in contrast to, for example, the High Council of Finance in Belgium and the Office for Budget Responsibility in the UK, the remits of which are confined to fiscal policy. But the broad tasks of the FPC are similar to those of some other watchdogs, such as the Central Planning Bureau in the Netherlands and the Economic Council in Denmark.[18] The broad remit in Sweden may be explained by the fact that raising employment was considered the primary economic-policy objective of the liberal-conservative government that established the Council.

There are both pros and cons with the FPC's broad remit. An argument in favour is the strong interaction between, on one hand, sustainable public finances and, on the other hand, high employment and growth. It also makes sense to use the expertise of a fiscal council in several policy areas. The drawback is, of course, that resources are spread more thinly.

According to Calmfors and Wren-Lewis (2011) 55 per cent of the quantitative contents of the FPC's reports in 2008-2010 was devoted to fiscal policy and 41 per cent to employment and growth (the remaining 4 per cent dealt with the Government's forecasts). Hence, despite the broad remit (which at the time gave equal emphasis to fiscal policy and growth/employment issues)[19], the major part of the Council's work has focused on fiscal policy, although a substantial part of it has dealt with other issues.

[17] See Wyplosz (2002, 2005, 2008), Calmfors (2003a, 2005), Annett et al. (2005) and Debrun et al. (2009) for surveys of various proposals.

[18] See Calmfors (2010) and Calmfors and Wren-Lewis (2011).

[19] See Section 5.5 below.

Calmfors and Wren-Lewis, however, also note that both media and politicians have showed more interest in the Council's analyses of employment/growth issues than in its analyses of fiscal policy. This might be seen as an indication that the broad remit diverts interest away from fiscal policy to other issues. But this interpretation is not self-evident. It could also be the case that fiscal issues receive *more* public interest than would otherwise be the case because the breadth of the reports increases interest in them in general. Moreover, given the strong public finances in Sweden it is not surprising that fiscal issues have not been at the forefront of the public debate.

*Evaluation of fiscal policy as a stabilisation tool*

The main reason for establishing an independent fiscal watchdog is to strengthen budget discipline and the role of long-term fiscal considerations. Against this background, how should one view the FPC's remit to evaluate the fiscal stance in relation to the cyclical situation? It is a more ambitious task than just to monitor the compliance of fiscal policy with the surplus target and the expenditure ceiling. It is, however, in line with a number of academic proposals on fiscal councils, which have focused exactly on such a role, as it has been recognised that inappropriate fiscal responses to cyclical developments have often been an important cause of deficit bias.[20]

According to the quantitative evaluation by Calmfors and Wren-Lewis (2011), the major part of the fiscal policy discussions in the FPC's reports have dealt with fiscal sustainability and the compliance of policy with the budget targets (60 per cent of the fiscal policy discussion) and only a smaller part with macroeconomic stabilisation.

It might seem surprising that the Council advocated a more expansionary fiscal policy stance than the Government during the 2009-2010 downturn. For example, the Minister for Finance expressed dismay over having created a fiscal watchdog and then finding that this body was more fiscally activist than the Government itself.[21]

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[20] See, for example, Wren-Lewis (1996), Ball (1997), Seidman (2001), Wyplosz (2002, 2005, 2008) and Calmfors (2003a,b, 2005).

[21] *Öppen utfrågning om Finanspolitiska rådets rapport* (2009) . A similar view was expressed by one of the Finance Ministry's state secretaries in a debate organised by the Swedish Economic Association (Hansson 2009).

It is, of course, to be expected that a fiscal watchdog for most of the time advocates more fiscal restraint than the Government, since the latter takes part in a political process where short-term considerations may lead to deficit bias. But it does not follow that this must *always* be the case for a council that is to monitor stabilisation policy efforts as well. Government policy often tends to build on very conventional wisdom and to adapt late to changed circumstances. The Council judged this to be the case in Sweden when the world financial crisis erupted in the autumn 2008. In the Council's view, the Government was then so heavily influenced by the doctrine that active use of discretionary fiscal policy as a countercyclical tool should normally be avoided that it failed to realise that the extraordinary circumstances motivated another stand, especially against the background of the strong Swedish public finances. The FPC felt it had an obligation in this situation to point to both the need and the room for countercyclical fiscal policy.[22]

There is an important analogy to monetary policy. It is a common view that independent central banking, by enhancing the credibility of low-inflation policy, has increased the scope for activist monetary policy in downturns. A similar argument could apply to an independent fiscal council. Since the Council is less likely to be suspected of having political motives for fiscal stimulus, which could lead to deficit bias, than the Government, it could be freer to make recommendations on such stimulus in a downturn and this way increase the scope for efficient stabilisation policy.

The FPC's advocacy of a more expansionary fiscal stance in the recession could also be seen as an attempt to avoid *procyclical* policy. Similar worries about procyclicality explain the Council's warnings that fiscal policy in the subsequent upswing risked becoming too expansionary.

*Evaluation of the budget targets*

The FPC has put a large emphasis on analysing the appropriateness of the surplus target in addition to monitoring compliance with it. This is a contentious issue, since it means that the Council acts both as a policeman for the budget targets and as a judge of them. In

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[22] See Section 4 above.

principle, the credibility of the Council, when policing the compliance with the budget targets, might be compromised if it is critical of the targets.

The reason why the FPC has put so much focus on evaluation of the surplus target is that it is a key factor in the evaluation of fiscal sustainability, which is one of the most important parts of the remit.[23] It seems a reasonable interpretation to view long-run fiscal sustainability as a *higher-level* constraint and the surplus target as an *intermediate* target to ensure that this constraint is met. It is impossible to evaluate fiscal sustainability without an analysis of whether the surplus target is compatible with it.

This interpretation has been criticised by the Government, which has maintained that ”the Council is to monitor the compliance with the objectives decided by the Parliament and not the objectives themselves”.[24] Since this stipulation is not logical and since it has not been written into the formal remit, the Council has chosen to ignore it.

*The Council as a debate watchdog*

A unique feature of the FPC’s remit is the task to monitor the motives, the research basis and the explanations for policy proposals given by the Government. This can be seen as a task of acting as a watchdog in the general economic policy debate.

Why has the Council been given this task? A possible answer is a long Swedish tradition of academic economists participating with a high profile in the public debate. It goes back to economists with an international fame like Knut Wicksell (who was jailed for blasphemy), Gustaf Cassel (who published around 1 500 op-eds), Gunnar Myrdal (who was a Social Democratic Minister), Bertil Ohlin (who was leader of the Swedish Liberal Party) and Assar Lindbeck (who in the 1980’s was instrumental in stopping trade union plans on socialising private corporations). Today – with the greater specialisation of research that has occurred – it is much more difficult for economists both to do qualified research and to participate in the public discussion. The establishment of the FPC can be seen as an attempt to institutionalise a high degree of interaction between academic research and economic policy, by seeing to it that at least some academics keep themselves updated on policy and participate continuously in the policy debate.

[23] See Section 3.
[24] Finansdepartementet (2011).

### 5.2 Resources and tasks

In an international comparison, the FPC's resources are very small. The current annual budget is below 1 million €. During the FPC's first four years of existence the budget was even smaller. It can pay only for a small secretariat (a head, two senior economists, a research assistant and an administrator) and the commissioning of 6-7 background reports from external researchers a year. As a consequence, the Council's academic members have to make heavy contributions to the report.

The FPC's limited resources constrain substantially the amount of analysis that can be undertaken. The Council cannot develop and administer own large macroeconomic models. Nor are the resources sufficient for making own forecasts, costing various government proposals or auditing the government accounts. These tasks are instead performed by other government institutions with much larger resources than the FPC.

The *National Institute for Economic Research* publishes regular macroeconomic forecasts and administers a large macroeconomic model that can be used to analyse the effects of various policy proposals. The *Office for Budget Management* publishes several times per year central government budget forecasts on the basis of detailed assessments and is responsible for the Government's annual financial statement. The *National Debt Office* also makes central government budget forecasts. The *National Audit Office*, an institution under the Parliament with its independence granted in the Constitution, has a broad mandate of monitoring all government activities. In addition to normal auditing, this institution carries out in-depth analyses in various areas. It also analyses the compliance of fiscal policy with the budget targets, although this is done with fewer resources and less research expertise than the FPC has.

The FPC has no formal right to request help from the other institutions mentioned. At times it has, however, used some of its resources to buy model work from them. This has in particular been done from the National Institute of Economic Research, which has provided model calculations of the employment effects and net costs of the earned income tax credit, analyses of government investment and the government capital stock, and evaluations of government net worth.[25] In other cases there has been more informal co-operation, when the Council has initiated work undertaken by the other institutions. One recent example is an analysis by the Office for Budget Management of the automatic changes of government expenditures resulting from various indexation rules.

Through the ways described, the Council's resources have been "leveraged". But the limited resources and the fact that analyses cannot be requested from other government institutions do limit the Council's output. As a consequence, instead of producing own detailed assessments and forecasts, the FPC has focused on broader evaluations of the Government's analyses and how they relate to established research. Although these evaluations do not necessarily require large resources they can be of high quality. For example, the Council has, sometimes with the help of external researchers, undertaken in-depth analyses of the size of automatic stabilisers and of the Government's calculations of the cyclically adjusted fiscal balance, of aggregate demand effects of fiscal consolidations in Sweden, of the length of the business cycles in Sweden in order to conclude whether the surplus target which applies to the business cycle has been met, of the critical government debt level at which interest rates are likely to start rising steeply, and of the employment and wage effects of the earned income tax credit.

There is some overlap between the activities of the Council and those of the other institutions 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.[26] The National Audit Office has, like the FPC, pinpointed ambiguities in the fiscal framework and has also analysed effects of particular policies. Such an overlap need not be a problem. On the contrary, it contributes to a pluralistic policy discussion.

The bottom line is that the Council can function with only small resources because there are other larger agents doing related work. This does not mean that these agents dominate the FPC in the public discussion: the Council's analyses and recommendations usually catch considerably more media attention.

[25] The FPC's secretariat is physically located in the premises of the National Institute of Economic Research. The Council's work is, however, performed independently from the Institute's. The Institute has no prior knowledge of the contents of the Council's reports.

[26] 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.

Notwithstanding all this, the FPC's small resources are a problem. The Council has only functioned because of the large input provided by the members. This work is performed as side activities in addition to full academic positions for most of the members, but widely exceeds what is reasonable for such side activities. The Council's long-run sustainability would seem to require that academic members can be freed from part of their ordinary duties during their periods of office. This applies in particular to the Council's Chair. The Chair's heavy workload meant that it was very difficult to fill this position in 2011 when the previous Chair (the author of this chapter) resigned.

**5.3 The FPC in the general political debate**

The FPC's remit to evaluate policies and the grounds for them comes close to assessing their appropriateness. Recommendations on appropriate policy cannot be made without also making value judgements. The Council has been very careful only to evaluate policies in relation to the aims stated by the Government. For example, when analysing the effects of the labour market reforms, the evaluations have only focused on whether they are likely to achieve the objective of raising employment, but not on their overall desirability when weighing these effects against those on income distribution.

Politicians frequently refer to the Council's analyses and conclusions. Although references are often selective and sometimes give a misleading picture, it must be judged favourably that such research-based inputs enter the political debate at all. The use of the FPC's analyses by *all* political parties is likely to raise the overall quality of the debate. An important role for the Council's analyses is also that they are frequently used by journalists to confront simplistic argumentations by politicians.

*Is there a political bias?*

An important problem concerns the possibility of a built-in *bias* in the effects of the FPC's evaluations on the political debate. The remit is to evaluate the Government's policies. It is natural that the analyses focus mainly on the scope for improvement rather than on praising the already good. Therefore, the reports are likely always to contain substantial parts that are critical of some government policies and recommendations on what the Council regards as better policies. But the opposition's proposals are not subjected to similar critical evaluations, as this is not part of the remit. This may create an impression that the Council is more critical of the Government's policies than of the alternatives proposed by the opposition, even when the reverse is the case. This has to some extent happened, as the FPC 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 require a change in the remit such that also opposition proposals are evaluated. This would imply a large extension of the remit. 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 Council's existence. This is because the Government has access to more analytical resources than the opposition.

Notwithstanding the above discussion, it appears as the Council has acquired a reputation for impartiality. There have been no accusations of partisanship and indeed, as discussed in Section 5.5, in 2011 there was a cross-party agreement endorsing the future existence of the council.

*The members and the Council*

The Council as a whole usually takes a policy stand only in the annual reports, but not in between the reports. An important question is to what extent Council members should be free to express their opinions in the public debate in between the reports. 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 economic policy" if Council membership would restrict participation in the general debate. Therefore the policy in this respect has been formulated as follows:

> "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".[27]

[27] This is stated on the council's webpage: www.finanspolitiskaradet.se.

In practice, it could still be a problem that the views of individual members (especially those of the Chair) are interpreted as being the views of the whole Council. The publicly expressed views of members are, however, likely to be constrained by the knowledge that it may be embarrassing to air a strong view and then later have to accept a compromise in the Council or be voted down. On the other hand, a strong public commitment may, as in all negotiations, be a means to improve a person's bargaining strength in the group.[28]

Council members have, however, abstained from public comments on the Government's economic policy immediately (around two months) before the publication of the annual report in May. For this reason, members have not commented on the Government's Spring Fiscal Policy Bill, which is published in April. This behaviour has not been guided by any formal rules, but there has been an implicit understanding among members that the report's impact is maximised if the thinking in it is presented at one occasion (including also reservations).[29]

### 5.4 The FPC's independence

A well-functioning Council requires independence from the political system in analogy with what is needed for central banks. A first issue concerns appointments. The members of the FPC are appointed by the Government. This represents a potential risk of political appointments. The risk is, however, balanced by the stipulation that appointments should be made after proposals from the Council itself (according to a blueprint from the Economic Council in Denmark). This creates a *reputation cost* for the Government of not following the proposals. The Council has tried to increase this cost by announcing its proposals publicly without prior consultation of the Government. So far, the Council's proposals have always been followed.

[28] An example is when the Council's Chair (the author of this chapter) in the autumn of 2008 took the public stand that the likely depth of the evolving recession motivated stronger fiscal stimulus than the Government had proposed in a situation when the majority of members were skeptical. The Chair's committing to this position may have helped swing the position of the Council's majority till the publication of the annual report in May 2009, but it also involved risk taking, since the Chair's situation would have become awkward if the Council in the end had not endorsed this view.

[29] According to the Council's statutes, dissenting views on the reports must be made public. To the four reports published in 2008-2011 there have in all been only three reservations: one in 2009 and two in 2011. The reservation in 2009 concerned the fiscal stance. The two reservations in 2011 concerned relatively minor issues.

It is a potential problem that the FPC is an agency under the Government rather than under the Parliament. Having the Parliament as the principal (as is the case for the National Audit Office) would have further stressed the Council's independence. It is unfortunate that the Council's head – 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 Ministry of Finance) where the Council's performance (in evaluating the Ministry) is discussed, since this discussion forms the basis for budget appropriations. The whole construction implies a risk for undue pressure from the Government.

During the FPC's first four years the Chair was also formally the head of the agency, which meant that the Chair was in charge of the Council's budget. This changed in 2011. The budget is now instead controlled by a separate head of the Council's secretariat, appointed by the Government without any formal say by the Council. Formally, the Chair can no longer decide the use of the Council's budget. With reasonable persons this may still work, with the head of the secretariat informally taking instructions from the Council members, who are the ones responsible for the reports. But in principle it is an awkward construction that could prove unworkable with the wrong persons involved. The Government's motivation for this strange construction is that it reduces the workload of the Chair and cuts it loose from the yearly discussions with the Ministry of Finance of how well the Council has performed its evaluation activities: these discussions will in the future be held with the head of the secretariat.

The most important guarantee for independent evaluations by the Council is probably the fact that the majority of members are academics, who are active mainly in another arena than that of the Council. There would be a high reputation cost in the academic arena for researchers who are 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 – everyone in a field such as economics knows each other. This is a strong argument for having also foreign members of the council, as has indeed been the case so far.

**5.5 The Council's legitimacy and long-run survival**

A criticism originally advanced against the Council was that it is "undemocratic" to have unelected experts evaluate elected representatives.[30] According to the argument, this would give experts too much power relative to politicians. The obvious counterargument is that the FPC 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.

The FPC's experiences illustrate a fundamental *time inconsistency* problem relating to independent watchdogs. On one hand, a government has an incentive to establish a watchdog as a way of signalling its determination to maintain fiscal discipline and possibly also, as in the Swedish case, to pursue research-based policies. On the other hand, once a watchdog is in place and criticises policy, there is a strong incentive for the Government to constrain its activities and perhaps also to effectively dismantle it. There are several such examples from other countries and there have been such ingredients in Sweden as well.[31]

When the liberal-conservative Government established the FPC in 2007, it was presented as an important addition to the fiscal framework.[32] But over time as the Council criticised parts of government policy – although on the whole making a positive evaluation of it – the Minister for Finance became increasingly critical about the Council in his public comments. A number of pejorative comments on both the Council's work and its Chair, of a type that have been unusual in the Swedish economic-policy debate, were made.

The Minister for Finance's hostility culminated in the late autumn of 2011 after the Council had sent an open letter to the Government, where it raised the worries about its situation that it had since its inception been discussing with the Government. The letter pointed to the large discrepancy between the Council's resources and its remit, to

[30] The Social Democrats argued in this way when the FPC 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" (Motion2 006/07:Fi10).

[31] See Calmfors and Wren-Lewis (2011).

[32] See, for example, Ministry of Finance (2009) and Finansdepartementet (2010).

the unsustainability of a situation where most Council members perform their work as side activities to their ordinary academic positions (implying that the universities fund a major part of the FPC's work) and advocated a change of principal from the Government to the Parliament to safeguard the Council's independence. The FPC's motivation for making these issues public was the view that the Ministry of Finance, because of dissatisfaction with the Council's critical evaluations of certain policies, was unwilling to give it more reasonable working conditions (in fact reneging on earlier promises to improve them) and wanted to "push the Council around" behind closed doors. The letter triggered a very negative reaction from the Minister for Finance, who threatened to cut down the FPC's resources because of "its wild-grown activities".[33]

The Minister's reaction was widely criticised in the press. The Council also received support from both the IMF (2010, 2011) and the OECD (2011), which made very favourable judgements of the quality of the Council's work and rather supported an increased role for it.

In February 2011, the Minister for Finance suddenly changed his position and invited the opposition to talks on how the Council could be strengthened at the same time as he started to praise its work. In April 2011, an agreement was concluded between the Government, the Social Democrats, the Greens and the Left. Although the agreement does not change the Council's status as an agency under the Government, it strengthens its position considerably as it is now endorsed also by the opposition parties that initially voted against its establishment. There is also now an implicit commitment that changes in the FPC's remit, status and resources should be decided in cross-party agreements.

The agreement implied somewhat larger resources for the Council. However, the sustainability problem arising from the fact that the bulk of the Council's work is done by its members as side activities to their ordinary employment remains. In fact, this problem has been exacerbated as the Government has now closed *all* possibilities to buy out members on part-time from their ordinary employment. Before, the Council could do this on a limited scale (it was done only for the Chair) to the extent that the budget permitted it. Now, the council has been explicitly forbidden to do so. It is difficult to interpret this in any other way than that the Government wants to put limits to how much work is put

[33] *Finanspolitiska rådet kräver mer* (2010).

down by Council members and thus how ambitious the reports can be. In fact, the Council has behind the scenes been advised by the responsible state secretary in the Ministry of Finance to lower its ambitions.

The cross-party agreement also involved some changes in the FPC's remit. According to the original statutes, evaluation of fiscal sustainability, monitoring that fiscal policy observed the budget targets, analysis of the fiscal stance in relation to the cyclical situation, monitoring of employment and growth developments, analysis of the transparency of policy, and evaluations of the government's forecasts and forecast models were of equal importance. The revision specified evaluation of fiscal sustainability and monitoring of the compliance of policy with the budget targets as the primary activities, and the other ones as activities that are *also* to be performed or that *may* be performed.[34] As discussed in Section 5.1, a case can be made for a narrower remit than the one the FPC had earlier. It is, however, disturbing that the revised remit downplays areas where the Council has been critical of government policy (such as the use of fiscal policy as a stabilisation instrument). Since analysis of the distribution of welfare was added as a task (on the initiative of the opposition parties), the idea does not seem to have been to narrow the remit in total.

## 6 Concluding comments

Two features stand out for the Swedish Fiscal Policy Council: the small amount of resources and the breadth of the remit.

Resources are probably too small for a sustainable activity of high quality. However, the Swedish case also illustrates the importance of the environment in which a fiscal council operates. In Sweden, there are a number of other agencies with substantial independence from the Government 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 FPC to focus on more overall judgements with a heavier research input.

The Council has a very broad remit. It should not only focus on long-run fiscal sustainability but also judge fiscal policy from a cyclical point of view. This is in line

[34] See Section 3,

with some of the academic proposals on fiscal councils in the international discussion. But the remit to evaluate growth, employment and welfare distribution goes beyond most of the earlier discussion on fiscal councils, although watchdogs in some other countries also have such tasks.

The FPC's broad remit might weaken its role as a fiscal watchdog. On the other hand, it is logical to analyse both employment and growth together with fiscal sustainability, since the former are crucial determinants of the latter. Having a broad remit with many issues to analyse probably also reduces the risk that the analyses will be seen as partisan, as the probability of disagreement with all political parties increases.

A unique feature of the Swedish Council's remit is monitoring of the motives, the research basis and the explanations for policy proposals given by the Government. This could be interpreted as the Council's key task since it is basically a fundamental service to democratic decision-making to help provide a good input into the public economic policy debate. Such a role for economists has a long tradition in Sweden.

The Swedish Council has in a relatively short time established itself as an important participant in the economic-policy discussion and acquired a reputation for competent and independent analysis. At the same time, the Council's experiences highlight the importance of providing sufficient funding from the start and formal guarantees for the independence of a fiscal watchdog. Underfunding and too close a *formal* association with the Government has resulted in an unnecessarily high level of conflict with the Minister for Finance when the council has tried to assert principles for fiscal watchdogs emphasised in the international discussion.

Another lesson from the discussion here is that there can be no uniform model for fiscal 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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