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Five countries, five models: A comparison of fiscal frameworks and lessons for Finland

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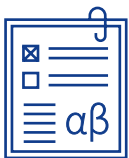
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Five Countries, Five Models

A COMPARISON OF FISCAL FRAMEWORKS AND LESSONS FOR FINLAND



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Abstract

In recent years, many countries have sought to transform their fiscal frameworks, with the aim of rendering their public finances more sustainable and preventing the emergence of fiscal problems. This report presents the findings of comparative research into the fiscal frameworks of five countries (Denmark, Ireland, the Netherlands, New Zealand and Sweden). All five countries have developed effective fiscal frameworks in the last two decades, and it is evident that they reflect both reactions to past episodes of fiscal laxity and the fostering of a broad consensus on the necessity of a more disciplined and robust framework.

There are noteworthy differences of approach, with the implication that rather than there being an optimal framework, successful ones can take different forms. It is never easy to transplant what works in one national setting to another, but there are several insights from experience in the comparator countries which could help to enhance the Finnish fiscal framework.

Tiivistelmä

Viisi maata, viisi mallia – Vertailu finanssi- poliittisista sääntökehikoista ja oppeja Suomelle

Monet maat ovat viime vuosina pyrkineet muuttamaan finanssipoliittisia sääntökehikoita tavoitteenaan vakauttaa julkisia talouksiaan ja estää finanssipoliittikan ongelmien syntymistä. Tämä raportti kokoaa yhteen tuloksia viiden maan (Alankomaat, Irlanti, Ruotsi, Tanska ja Uusi-Seelanti) finanssipoliittisia sääntökehikoita vertailevasta tutkimuksesta. Kaikki viisi maata ovat kehittäneet tehokkaita sääntökehikoita kahden viime vuosikymmenen aikana. Ne ovat syntyneet reaktion menneisiin finanssipoliittikan ongelmiin, ja heijastelevat laajaa yhteisymmärrystä kurinalaisemman ja vankemman sääntökehikon tarpeellisuudesta.

Tutkimus osoittaa, että onnistunut sääntökehikko voidaan toteuttaa monella eri tavalla. Vaikka yhdessä maassa toimivaa menettelytapaa ei ole aina mahdollista siirtää suoraan toiseen, voivat vertailumaista saadut kokemukset auttaa kehittämään myös Suomen finanssipoliittista sääntökehikkoa.

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Kiitokset: Tämä julkaisu on toteutettu osana valtioneuvoston selvitys- ja tutkimussuunnitelman toimeenpanoa (tietokayttoon.fi). Julkaisun sisällöstä vastaavat tiedon tuottajat, eikä tekstisisältö välttämättä edusta valtioneuvoston näkemystä. Olemme kiitollisia asiantuntijoille, jotka osallistuivat haastatteluihin ja jakoivat näkemyksiään ja kokemuksiaan kanssamme. Heidän panoksensa oli korvaamaton Suomen kehysjärjestelmää koskevan tutkimuksen tulosten muotoilussa ja syventämisessä. Lopuksi haluamme kiittää hankkeen ohjausryhmää ja kollegoitamme heidän ohjauksestaan ja palautteestaan koko tutkimusprosessin ajan.

Keywords: Fiscal policy, Fiscal rules, Expenditure ceilings

Asiasanat: Finanssipoliitiikka, Finanssipoliittikan säännöt, Menokehys

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Executive summary

This report presents the findings of comparative research into the fiscal frameworks of five countries considered to be comparable with Finland, and thus able to offer insights into possible reforms of the Finnish framework. They are: Denmark, Ireland, the Netherlands, New Zealand and Sweden.

All five countries, as did Finland, have developed effective fiscal frameworks in the last two decades, and it is evident that they reflect both reactions to past episodes of fiscal laxity and the fostering of a broad consensus on the necessity of a more disciplined and robust framework.

Variations on a fiscal responsibility act typically provide the legal underpinning for frameworks, and setting a pathway for the level of public expenditure (an expenditure rule) is central to the various approaches. Nevertheless, there are noteworthy differences of approach, with the implication that rather than there being an optimal framework, successful ones can take different forms.

There are notable differences in practice in how expenditure rules are implemented. These include the proportion of government spending they cover, how to account for inflation, and adjustments to reflect cyclical fluctuations. However, a common feature is the expectation that the rule will, in normal circumstances be adhered to, with the corollary that deviations from it are political costly.

A significant shortcoming in many fiscal frameworks is the limited attention paid to long run fiscal sustainability, although the indications are that it is an aspect of framework attracting increasing attention.

In times of crisis, difficult decisions need to be made about how and when to suspend fiscal rules. The evidence suggest discretion is to be preferred to explicit escape clauses, but also that more emphasis should be placed on the pathway to restoration of the fiscal rules.

What constitutes sustainable debt is hard to gauge. Sweden has an explicit numerical target and Euro Area countries are supposed to abide by the 60% of GDP (other EU Member States too, but with fewer consequences if they exceed the threshold). In light of the November 2022 proposals by the European Commission to recast EU fiscal commitments, the aims and techniques of debt sustainability analysis need to be refined.

For each of the comparator countries, the report presents brief ‘snapshots’ of the key features of its fiscal framework, together with an assessment drawing on the interviews and background work and an attempt to identify challenges facing fiscal policy.

Examples of distinctive features include:

- ... the decision-making sequence in Sweden, in which the aggregate expenditure ceiling is agreed in a first parliamentary vote and the allocation among spending programmes in a second;
- ... the lack of an independent fiscal institution (IFI) in New Zealand, where an emphasis on transparency is central to the approach and is considered to be a sufficient means of putting pressure on governments;
- ... Ireland’s recent introduction of an annual nominal increase in the expenditure total, initially set at 5% and based on 3 points of real growth and inflation of two points – it has since been increased to 6.5% nominal growth;
- ... Denmark and the Netherlands have long-established IFIs which, in the case of the latter undertake much more extensive research and analysis than elsewhere;
- ... some innovations in how to encompass longer-term fiscal developments, for example an eight-year cycle in Sweden;
- ... discretion, rather than formal escape clauses, is the norm in dealing with significant fiscal demands, such as those emanating from the pandemic.

It is never easy to transplant what works in one national setting to another, but there are several insights from experience in the comparator countries which could help to enhance the Finnish fiscal framework.

- ... The trend-based expenditure rule applied in Finland is accepted as good practice, but other countries have proved better able to return to its constraints after they are eased in exceptional times, such as financial crises or the pandemic.
- ... Finland does not pay as much attention to the longer term as others. It would be useful to have a regular and formal review of the long-term sustainability of fiscal policy as a basis for setting medium-term objectives for fiscal policy.
- ... In decision-making, there is a case for separating the decision by parliament on the aggregate expenditure rule from the allocations by spending ministry in a second stage.
- ... Finland has a stable tax system and should keep tax and expenditure decisions separate.
- ... Although the scrutiny of fiscal policy by a division of the Audit Office (strengthened in line with recent recommendations from an OECD review) and by the Economic Council is effective and fulfils many of the expectations of an IFI, there is nevertheless a case for going further to set up an independent entity, as in four of the comparator countries.
- ... Transparency matters, but also needs more than the passive approach of publication of documents. An active policy transparency is encouraged, including through an independent fiscal council boosting media engagement.

1 Introduction

In recent years, many countries have sought to transform their fiscal frameworks, with the aim of rendering their public finances more sustainable and preventing the emergence of fiscal problems. In several cases, the development of the fiscal framework was motivated by past problems or deeper crises, and a motivation derived from a sentiment of ‘never again’ is prominent.

This report presents the findings of research into the fiscal framework in five countries which are sufficiently comparable to Finland to offer the prospect of yielding lessons for reforms. Two are Eurozone members, Ireland and the Netherlands; two are geographically close neighbours which might be expected to have similar governance cultures, Denmark and Sweden; while the fifth, New Zealand, has a similar economic size and population to Finland, and has a sizeable primary sector.

The research undertaken consisted of desk research to establish the key features of the respective fiscal frameworks and interviews with experts. The research team has been impressed by the willingness of these interviewees to engage with the project and to provide invaluable insights, and is very grateful to all of them for taking part and drawing attention to relevant documents and developments of the frameworks.¹

1.1 Approach to interviews

To steer the discussion with experts, an ‘interview guide’ was developed, covering the various aspects of interest in the national fiscal frameworks. This approach was preferred to a more structured questionnaire for two reasons: first it avoided the need to pose simple (even, simplistic) questions on which answers could readily be found by desk research; second it allowed for a degree of customisation to enable the interview to focus on issues the interlocutor was best placed to answer or explain. This guide and a provisional report on the country were sent in advance to the interviewee, in several cases eliciting helpful corrections of the draft report.

In all countries, the list of interviewees included representatives of the ministry of finance, complemented by discussion with independent experts and representatives of other public agencies, notably the national ‘fiscal watchdog’. In addition, officials from

¹ None of the interviewees is named in the report, other than in the list provided as annex 2, and in the small number of instances where there is a direct citation from an interview, it is anonymised. The views expressed by the interviewees do not necessarily represent the views of the entity by which they are employed.

the IMF and the European Commission were consulted. A list of the interviewees is appended. Interviews were conducted using Teams which allowed an automatic transcript to be taken (subject to obtaining the permission of the interviewees, none of whom refused), greatly simplifying the task of keeping a full account of what was said. Indeed, the project team was agreeably surprised by the quality of the transcripts. To complement the interviews and analyses, a 'validation' workshop was organized at a late stage of the study. Its purpose was to allow the interviewees and the project steering group to discuss the results of the comparison of national fiscal frameworks and reform proposals of the Finnish framework.

1.2 Structure of this report

The remainder of this report is structured as follows. The next section presents snapshots of the most salient features of the five frameworks studied, together with a summary table. Subsequent sections, summarise the main findings, focusing on features that contribute to, or detract from, the effectiveness of fiscal frameworks, then at the governance arrangements underpinning them. A concluding section teases out possible lessons for Finland from the arrangements and experiences of the five other countries. An annex contains fuller reports on the five comparator countries.

2 Snapshots of the fiscal frameworks in five comparator countries

This section presents concise descriptions of the arrangements in each case studied, highlighting their most distinctive features, and gives a brief assessment of its performance and challenges it faces. Table 1 provides a synopsis of the main features of the respective frameworks, with the last column showing how Finland compares with them. What is striking about the table is the extent to which key attributes are the same or similar in many respects, even though a few of them, as noted above, are divergent. To complement these snapshots of the comparator countries, the box below concisely summarises the Finnish approach.

BOX 1: THE FINNISH EXPENDITURE CEILINGS

Since 2003 the Finnish Government has agreed on expenditure ceilings on budgetary expenditure for the duration of the four-year term of Government office. A framework of expenditure ceilings had been in place since 1991, but until 2003 they covered only the following budgetary year. With the extension of the time frame to cover the following 4 years, the framework essentially became a fiscal planning tool for the medium term.

The purpose of the Finnish medium term budgetary framework (MTBF) is to limit the growth of central government budgetary expenditure. The framework is not enshrined in law but is based on a political agreement among the governing parties. The expenditure ceiling is set at the beginning of the government term for the following 4 years as part of the Government Programme and it is included in the Government Fiscal Plan.

The expenditure ceiling is a monetary aggregate covering approximately 35-40 % of the whole of government expenditure, and 69-80 % of the central government budgetary expenditure. Among the excluded budgetary expenditure are automatic stabilizers and interest payments on government debt.

The expenditure ceiling is initially set in real terms and the price adjusted each year. Setting the level of the expenditure ceiling – i.e. the maximum amount of central government budgetary expenditure during the government office - is at the discretion of the government.

The explicit purpose of the expenditure ceiling in the 2000s has been to limit the growth of central government budgetary expenditure.

2.1 Denmark

Denmark's chequered history with the conduct of fiscal policy manifestly influenced the system now in place, one which has, certainly since reform enacted in the aftermath of the global financial crisis, proved to be broadly successful in dealing with the sources of recurrent spending overruns and setting the public finances on a sustainable path. There are four-year expenditure ceilings based on medium-term projections, and increasing attention is being paid to the longer term in setting fiscal policy.

The most significant move to put an end to recurrent spending overruns was the enactment in 2012 of the Budget Law, which also incorporated the EU fiscal compact into Danish law. This Law introduced a lower limit for the annual structural budget balance and binding multiannual expenditure ceilings for central government, municipalities and regions (starting from 2014), as key measures. Fiscal policy was to be planned such that the annual structural budget balance would not exceed a deficit of 0.5% of GDP at the time of the budget proposal for a given fiscal year, unless there were extraordinary circumstances (The Danish Ministry of Finance, 2021). In calculating the structural budget balance, the Danish authorities use their own method which is more stable and puts more emphasis on directly observable variables than the common EU method.

Over time, the focus of strategy has changed from an explicit target for lowering public debt to an overarching objective of long-term sustainability of public finances, taking into account projections of future pension and other ageing-related expenditure. In preparation for future demographic pressures, gross debt has been reduced to around 30% of GDP and the government has built up a positive net financial asset position. The medium-term structural balance target is set at zero in 2025 and -0,5% of GDP in 2030. The lower limit of the structural deficit was revised in March 2022 and lowered to 1% of GDP, effective from 1st July 2022 (The Danish Ministry of Finance, 2022).

The fiscal watchdog function is provided by the Economic Councils (in the plural, because there are two), an institution widely respected across the political parties and by civil society. The economic element of the Councils assesses long-term fiscal sustainability and the medium-term development of the budget balance, as well as whether the expenditure ceilings are complied with and align with the medium-term fiscal objectives.

Assessment of the framework

According to Lobe Suenson et al. (2016) the 2012 budget law 'was adopted in order to break with 35 years of budget overruns which had resulted in comparatively high

public spending growth'. One of the main reasons for these overruns was the lack of enforceable sanctions on municipal governments. In 2011, this was addressed by imposing automatic sanctions on budget overruns in the municipalities. The sanctions were afterwards adapted in connection with the Budget Law in 2012. With the Budget Law, Denmark introduced very stringent stipulations regarding how the government, regions and municipalities must respond to breaches of the ceilings. If the central government ceilings are not respected, the Minister responsible must implement corrective measures immediately. If this fails, the Ministry of Finance shall reduce the ceiling of the following year by the appropriate amount.

The expenditure ceilings, in place since 2014, have never been exceeded and this success is attributed by interviewees not just to the sanction rules, but also the consensus on the benefits of fiscal discipline. Recent years have not seen any budget overruns relative to budget plans, in sharp contrast to the preceding decade. Maastricht debt had fallen from 46.1% of GDP in 2011 to 33.7% in 2019, with surpluses in each year from 2014. As elsewhere, Denmark borrowed to fund its pandemic response in 2020, but quickly reverted to its existing expenditure plans after the pandemic, and Maastricht debt has continued to fall, reaching 29.5% in 2022.

The pivotal role of the Economic Councils and the effectiveness of their scrutiny of the government's fiscal proposals was highlighted by interviewees. The Councils also contributed to transparency by being visible in the media. More generally, transparency is enhanced by the relative simplicity of the fiscal framework and the clarity with which it is explained to the public.

Challenges

The Danish framework has undoubtedly worked as intended thus far. As elsewhere, however, the framework will be tested in future in how it accommodates demographic and climate change related problems. As in other similar richer countries, the projected old-age dependency ratio² of Denmark is on the rise. The rules-based, yet in exceptional circumstances pragmatic, and forward-looking way of organizing their public finances will still leave the Danes in a good position to tackle these future challenges. Projections are made decades ahead and fiscal strategy is tailored to ensure long-term sustainability. Overall, the interviewees adjudged the current fiscal framework to be effective and robust.

² This indicator is the ratio between the projected number of persons aged 65 and over (age when they are generally economically inactive) and the projected number of persons aged between 15 and 64. The value is expressed per 100 persons of working age (15-64). (Eurostat, 2022).

2.2 Ireland

Although it was the solvency of the banking system, not fiscal policy per se that triggered the major economic crisis suffered by Ireland as a result of the global financial crisis, it led to a rethink of its fiscal framework. The system now in place is linked to EU commitments, but has its own features, partly to cope with the unusual structure of the economy in which very large fluctuations in annual tax revenue from multinational corporations distort the true state of the public finances. For much the same reason, the calculation of the structural balance using the European Commission methodology is badly inaccurate. An expenditure rule, consistent with EU obligations, is at the core of the system and has recently been revised to include a target for the growth, in nominal terms, of government spending.

In Ireland, the preferred measure of the performance of the economy is known as GNI*. As explained by the Irish Central Statistics Office³, the principal adjustment is to exclude what it calls globalisation effects associated with the activity of so many large multinational companies. GNI* “differs from GDP by the net amount of incomes sent to or received from abroad, so it excludes the net profits of companies that have been sent abroad”. It also corrects for volatile movements in depreciation of intellectual property and of leased aircraft – the latter reflecting a sector prominent in the Irish economy. The adjustment to GNI* results in both a lower headline total for the size of the economy and lower growth; these in turn mean fiscal ratios are less favourable than routinely published in comparative tables of EU member states.

An IFI, the Irish Fiscal Advisory Council, was set up informally 2011 and formalised in 2012, ostensibly in response to EU governance reform, but also in response to domestic rethinking of the institutional context. It quickly gained acceptance and has since played a role in enhancing fiscal discipline, despite some disagreements with the government. Its reports are widely used by the media in a parallel channel of accountability.

Assessment of the framework

From difficult beginnings as Ireland implemented the adjustment programme associated with its bailout in 2010, the Irish fiscal framework had proved its worth in the second half of the 2010s. However, according to one interviewee, it remains ‘fragile’. As explained above, the prominence of multinational corporations distorts both growth and public finance data, making the performance of the economy harder to judge than

³ <https://www.cso.ie/en/interactivezone/statisticsexplained/nationalaccountsexplained/modifiedgni/>

in other comparator countries, although the evidence from interviewees is that published EU or OECD data present an overly positive picture. The Commission's assessment of Ireland's draft budget for 2023 was that it 'is in line with the fiscal guidance' issued by the Council. However, a potential concern is that the provisions for annual adjustments in the expenditure ceiling offer too much scope for politically motivated changes.

Interactions between the IFI and the government, though sometimes strained, have contributed to a better quality of scrutiny and the strong sense of 'never again' seems to have been assimilated by political parties and other stakeholders. The response to the pandemic was proportionate and did not call into question the main features of the framework.

Challenges

What to do with the fluctuations in taxes declared by multinationals, sometimes resulting in massive windfall gains, is a difficult issue for fiscal governance, not least because it can give rise to public pressures for increased spending or tax cuts if the inflows are large. A rainy-day fund or some form of sovereign wealth fund are ideas receiving attention, but with no clear proposal yet put forward.

In 2019, the government adopted a new norm of 5% nominal expenditure growth, of which 3 points were real growth and 2 points inflation. For 2023, the rise is to be 6.5% which could be a cut in real terms if the inflation rate remains closer to 10%. The problem may dissipate if inflation abates quickly, but it does highlight the perils of targeting a fixed rate of growth of fiscal aggregates.

2.3 Netherlands

The Dutch framework is considered to be effective and has enabled the government to remain comfortably in line with EU obligations. There is a trend-based expenditure ceiling, covering four main sectors: government, social protection, health and public investment. The ceiling is the outcome of a process culminating in a coalition agreement and is normally expected to last for the duration of the government. Revenue can fluctuate and is the main means by which automatic fiscal stabilisers function (acting, therefore, in a counter-cyclical way). The treatment of discretionary or windfall revenues (or setbacks) has interesting characteristics. The income "ceiling" (some interviewees suggested it should be called a rule) operates in a way that prevents amendments to expenditure plans. This can lead to unplanned tightening or easing of

the fiscal stance, but is justified on the grounds that whereas government can control spending, it is less able to do so for revenue.

Since the early post-war years, a distinctive and crucial role in the Dutch framework has been played by the independent Centraal Plan Bureau (CPB). It provides independent forecasts and a range of other analyses and, most recently, has been studying the longer-term aspects of sustainability. The CPB also assesses party proposals in advance of elections, in a strictly non-partisan way. A separate body, the Council of State, has a complementary fiscal watchdog role, and is charged with assessing compliance with national and EU rules. The Council of State advises the government and Parliament on legislation and (economic) governance and is one of the High Councils of State. Their independence is guaranteed in the Constitution and this ensures they are able to carry out their tasks independently of the government. This institutional standing means, as a watchdog, it can not only bark but bite. In addition, a non-partisan advisory group, the Studiegroep Begrotingsruimte (SBR), composed of high-level officials plus the Governor of the Central Bank and the Director of the CPB uses the CPB's medium term projections to provide (non-binding, although they are not easy for the government to ignore) recommendations to the in-coming government.

The 2013 Sustainable Public Finances Act (Wet HOF) codified the basic elements of the Dutch trend-based fiscal policy, already established, as well as obligations related to EU commitments, notably the Stability and Growth Pact (SGP). It also enhanced the monitoring of fiscal compliance. In 2010, before the Wet HOF was passed, the Netherlands was put in the corrective arm of the SGP and was required to report under the Excessive Deficit Procedure between 2010–2014.⁴ After targets were met, the annual budgetary process in the Netherlands has been more focused on the national expenditure ceilings and the deficit target at the end of the four-year government term, rather than abiding by the EU's MTO. Therefore, meeting it is merely an outcome and not a target in the Netherlands (Vierke and Masselink, 2017, in a paper for the Commission).

Assessment of the framework

All the interviewees praised the fiscal framework and stressed that it has cross-party support, all the more noteworthy because there are so many parties. As in most EU member states (notably, though, not in Finland), the debt ratio fell between 2014 and 2019, albeit faster in the Netherlands – 67.9% of GDP in 2014 to 48.5% in 2019 – compared with 86.9% in 2014 to 77.5% in 2019 in EU27 countries. After the Wet

⁴ If a country fails to meet the objectives set in the SGP, they are put into the corrective arm of the SGP in which they must take actions to return to following the objectives by implementing the Excessive Deficit Procedure (EDP).

HOF, the deficits first fell and subsequently turned into surpluses from 2016. In its assessment of the draft budgetary plans for 2023, the Commission rates the Netherlands as being in line with the relevant guidance.

The arrangement for independent contributions to the fiscal framework are both distinctive and effective. As a long-established and powerful agency, the CPB has high standing in the system and the role of the Council of State in monitoring national and specifically compliance with EU rules is distinctive. Yet the evidence from the interviewees suggests that the EU rules are more in the background than a central element of the fiscal framework. This is corroborated by Vierke and Masselink⁵ who note various way in which the national and EU framework are not aligned, even though the Netherlands' fiscal sustainability is not at risk. The proposed new EU approach may well go a long way towards reconciling these discrepancies.

Challenges

The trend-based framework is highly effective in enabling counter-cyclical fiscal policy. During growth periods, the Government accrues buffers to be used in downturns. The challenge comes from defining when it is appropriate to deem a situation extraordinary and to allow for expenditure to be placed outside of the expenditure ceiling.

Long-term fiscal sustainability, especially in terms of financing an aging population's needs, is a challenge, as with most developed nations. There is no clear link between the medium- and long-term in terms of fiscal tools, but the Dutch have built-up large funds to finance such things as pensions, investments, climate action etc. For instance, the state-funded pension fund ABP is among the largest in the world (WTW, 2022). There is also plenty of discussion around long-term fiscal sustainability and it is notable that the CPB calculates generational accounts for 30 years ahead highlighting these issues. How to incorporate these and other public assets into the framework, and not just the liabilities side of the public balance sheet, is a live issue.

There is plenty of information on the system, implying a high degree of transparency. However, the complexity of the framework and the lengthy process leading up to a coalition agreement can make communicating it (especially to the public) harder, a point mentioned by all the interviewees.

⁵ Vierke, H, and Messelink, M. (2017) 'The Dutch fiscal framework and the European fiscal rules, *European Economy Economic Brief* 27, https://economy-finance.ec.europa.eu/system/files/2020-12/eb027_en.pdf

2.4 New Zealand

As is immediately visible from the New Zealand Treasury's own online description, transparency is at the heart of its approach. There is neither an explicit fiscal rule nor an IFI, with the rationale being that public scrutiny is sufficiently great to deter governments from risky fiscal policy. The absence of rules gives each government (the parliamentary term is just three years) the scope to reach its own decisions about the appropriate level of debt, but it is claimed that it also strengthens the commitment to stick to these plans without having to abide by what could be economically inappropriate rules.

At the heart of the framework is the obligation to balance operating spending and revenues – in effect including investment which should be financed by borrowing. This is a golden rule of sorts, yet also relies on independent bodies such as the Infrastructure Commission (established in 2019) which is charged with infrastructure planning and delivery at a strategic level, with the aim of improving economic performance and social wellbeing. Its mandate includes providing leadership but also trying to optimise the mix of public and private funding of projects.

The Treasury (i.e. Finance Ministry) produces long-term fiscal statements at least every four years (spanning up to 40 years ahead) which attempt to anticipate future fiscal trends. However, these do not appear greatly to influence government plans.

There has been discussion about whether an IFI should be established, partly reflecting pressures from the IMF or the OECD, both of which do have a de facto role in this respect. However, there are no immediate proposals on the table in this regard.

Assessment of the framework

There is a political consensus on commitment to the fiscal framework and the empirical evidence suggests that the country's public finances have been comfortably sustainable. They also, more than systems more formally rule-based, afford more room for political choice, on the basis that the over-arching principles are respected. Ownership is strong, with each Government being able to define the parameters themselves. Transparency helps, because opposition parties, the media and the public are able to keep track of what governments do and thereby hold them to account. Debt (measured in a different way from the EU's 'Maastricht' methodology) fell substantially after the framework was initiated, but has since started to rise, albeit not to a level that might jeopardise fiscal sustainability.

Challenges

The follow-up to pandemic-related suspension of normal provisions is uncertain and will be influenced by the outcome of imminent elections. There is an open question about whether transparency will continue to suffice or, instead, an IFI should be introduced.

2.5 Sweden

Sweden also recast its fiscal framework following the severe economic and budgetary crisis of the early 1990s, and the resulting arrangements are widely supported by political parties and citizens. There is an expenditure rule, in place since 1997, with a wide coverage, albeit unusual in being expressed in nominal terms, rather than being trend-based. Other key features include a one third of a per cent of GDP surplus target for general government net lending and a 35% of GDP general government consolidated gross debt anchor, with the anchor seen as a basis for medium term sustainability, rather than a constraint on the annual budget. These parameters are reviewed every other electoral period.

A notable aspect of the budget process is that the parliament is asked first to approve the aggregate expenditure ceiling, and only in a second vote to agree the allocation of spending. This process has the important implication that the government would be obliged to return to parliament if it decided to increase the expenditure ceiling, something it would be reluctant to do because of the resulting 'loss of face'. Unlike Denmark, the central government does not have instruments for controlling the expenditure of local government, although the latter are obliged to balance their budgets, meaning few obvious risks for the sustainability of general government finances.

The Fiscal Policy Council, established in 2007, just as the global financial crisis started and before becoming something expected of EU member states, has become a key part of the system. Further independent institutions complement the fiscal council, although the Council has the most high-profile role. Its reports and analyses are widely used by the media and the Council's mandate also allows it to examine issues outside fiscal policy. The National Institute of Economic Research and the National Financial Management Authority assess macroeconomic and public sector financial developments, and present recommendations on fiscal policy. All are used by the media to hold the government to account.

Assessment of the framework

The Swedish fiscal framework appears to have worked well: government debt has fallen, markedly since the 1990s and general government has also been posting surpluses most years since. Indeed, one interviewee observed that Sweden now has the best framework in the world. It has more flexibility than most peers through the buffer between agreed spending and the ceiling, but in a period of rapid inflation this could be a problem if public sector wages rise more rapidly. Expenditure ceilings have not been exceeded, though the ceilings have on occasion been raised, despite the reputational costs for the government of asking for the change.

The independent scrutiny has worked well and has contributed to disciplined public finances, and the Fiscal Policy Council has, using the discretion in its mandate, also contributed to debate on topics outside fiscal policy. Although the surplus target has, latterly, been reduced, Swedish public finances provided plenty of room for manoeuvre for dealing with the pandemic.

Challenges

A nominal expenditure target works well in a low inflation context, but could be more awkward if inflation were to become more entrenched. However, the buffer in the expenditure ceiling still offers some protection.

Table 1. Synoptic Overview of Attributes of Comparator Countries

Features of fiscal arrangements	Denmark	Ireland	Netherlands	New Zealand	Sweden	Finland
Fiscal responsibility legislation	Yes, since 2012	Yes, since 2012	Yes, since 2013	Yes, since 1994	Yes, since 1997	Yes, since 1992
Independent fiscal watchdog ⁶	Yes, since 1962	Yes, since 2012	Yes, since 1945	None	Yes, since 2007	Yes, since 2013
Explicit numerical targets	Medium-term fiscal balance and long-term sustainability targets	5% annual nominal increase limit in spending (6.5% for 2023) and Euro rules	Euro rules: limits of 3% of GDP structural budget deficit and 60% of GDP Maastricht debt	Each government can set their own targets in the beginning of the 3-year term.	35% of GDP Maastricht debt anchor and 1/3% of GDP structural budget surplus target	Euro rules: limits of 3% of GDP structural budget deficit and 60% of GDP Maastricht debt
Expenditure rule	Legally binding multiannual expenditure ceilings for central government, municipalities and regions covering around 75% of	Legally binding multiannual expenditure ceiling applying to almost all public spending.	Multiannual expenditure ceiling covers between 80–90% of general government expenditure.	No expenditure ceiling, but a set target to ensure expenses are consistent with the operating balance before gains and	Expenditure ceiling that covers nearly all central government spending. It is set in nominal terms	Multiannual expenditure ceiling that covers around 69–80% of the central government spending after

⁶ A formal requirement for the EU countries was enacted in 2011, but some of the countries have had such institutions long before it was required. In Finland, the IFi is part of the Audit Office, albeit with provisions to protect the independence of its judgements.

public expenditure.	losses (OBEGAL).	for three years at a time.	the funding of welfare counties was moved under it in 2023.
Explicit provision for longer-term	Structural budget balance target based on long-term calculations of fiscal sustainability	Spending increase limit is based on medium- to long-term provisions	Plethora of long-term targets such as the debt and OBEGAL targets
Budget balance target ⁷	Zero in 2025 and -0.5% of GDP in 2030 with a legislated lower limit: 1% of GDP structural budget deficit limit	Public investment and pension funds	Debt anchor to which the surplus target is linked to
		None	1/3% of GDP structural budget surplus target
		None	None
		Seeking to maintain steady surpluses to the OBEGAL on average within a band of zero to two percent of GDP.	
Debt anchor	None	None	35% of GDP Maastricht debt
		Maintain net debt ⁸ at below 30 percent of GDP	None

⁷ This and the debt anchor row below it do not include the structural budget balance or Maastricht debt requirements set by the SGP.

⁸ Definition further explained in detail in the Annex.

Simultaneous agreement of aggregate and detailed spending	Yes, to some extent. Much detail agreed annually, however, within the aggregate.	Yes	Yes, but the budget bill must pass two stages: the House of Representatives and then the Senate.	A separate vote for each subject area group and appropriations within them first presented together in the Budget Policy Statement.	No. First, a vote on the overall level and then on allocation.	None
Role of parliament	Medium	Weak	Strong	Strong	Strong	Weak
Use of an escape clause during the pandemic	Yes	Yes	Yes	Yes	No, although expenditure ceilings were raised	Yes
↳ Path back to normality	Successful	Successful	Successful	Successful	Successful	Incomplete
Relations with EU obligations	Legislated. Framework is designed to be consistent with EU rules.	Legislated but unclear because of the difficulty of calculating GDP accurately	Legislated but not restrictive. Complex conversion between the EU fiscal rules and	No relation	Not nationally legislated and not restrictive	Legislated but not (thus far) restrictive

national budgetary data.⁹

Effectiveness	Effective	Effective	Effective	Effective	Effective ¹⁰
Possible weaknesses	Multiple targets (1-year, 4-year, medium-term and long-term) could impede transparency and in some cases flexibility.	Difficulty of applying EU rules due to different calculation methods, public pressure to spend windfalls brought in by the multinationals	Reliance on political commitment ¹¹ , complexity of the framework	Reliance on political commitment not least due to the lack of an IFI	Reliance on political commitment, low coverage, weak links between long- and medium-term targets
Features to advocate for others	Clear links between long- and medium-term targets	A nominal 5% spending increase rule	Strong IFI with broad remit	Focus on transparency	Trend-based approach

⁹ "In the Netherlands, due to different definitions between the SGP fiscal rules and the data from the budget system that Parliament receives, the latter needs to be converted by the MoF and the CBS specialists. Although this conversion is shown on the MoF website, the complexity reduces transparency." (The Fiscal Policy Audit Network, 2022).

¹⁰ Until the Covid-19 pandemic required extraordinary measures from which return back to normality was not achieved.

¹¹ Can adversely be seen as a strength of a framework too.

3 Overview of key findings

An important general finding is that, despite some notable differences in how they are configured, the five countries studied have effective fiscal frameworks. This finding has two immediate implications. First, it signals that there is no ‘ideal’ model for the design of a fiscal framework, a corollary of which is that there can be diverse means of achieving the underlying objectives. Second, a framework contains a plethora of ‘moving parts’ and the manner in which they interact is often more crucial than whether or not a particular feature is absent or present. For EU Member States, however – more so for those participating in the euro – the interaction between legally-binding EU obligations and national provisions can be a further consideration, although for Finland and the four European comparator countries, respect of national rules already ensures compliance with EU rules.

History and culture also emerge as significant influences. Episodes of deep economic crisis, often including acute problems in the public finances, have manifestly exerted a powerful influence on how frameworks have evolved: as mentioned above, ‘never again’ is a potent motivation. At the same time, trust in institutions and political consensus are vital. Crises also offer opportunities for innovations aimed at increasing the robustness of budgetary frameworks, such as the introduction of independent fiscal institutions in countries which did not previously have them.

3.1 Legal provisions

A rigid legal framework encompassing rules and targets is not necessary for a successful fiscal framework and may, in some circumstances, create complications leading to perverse policy choices. However, a broad fiscal responsibility (or similar wording) law is commonly found, including in the five case-study countries. Even, as in New Zealand, where there is an expectation in the Public Finance Act 1989 that the government should aim for a balance between operating revenues and expenditure, it

is not a rigid balanced budget rule; instead, it is about a programme for government for the duration of the parliamentary term.

An important finding of the research is that a national consensus on the aims and modalities of the fiscal framework is important. What this means is not easy to define, nor is it obvious if, or in what circumstances, such a consensus might come under threat, but it was a point stressed in most of the interviews. The benefits are, nevertheless, clear: cross-party agreement (and voter expectations) on keeping within the framework reinforces public confidence in the government plan, and even healthy political contestation on tax mixes or spending priorities does not extend into undermining the system. Governments have to take ownership and show responsibility. Consensus also helps to deal with economic or other shocks, insofar as it makes it easier to agree on difficult policy choices.

3.2 The nature of expenditure rules and treatment of revenues

The comparisons reveal two main approaches to the implementation of expenditure rules: a nominal ceiling (as in Sweden) with an unallocated buffer to meet unexpected spending priorities; and trend-based systems (as in Finland) which take account of cyclical fluctuations in the rate of growth. Both have their merits, although the latter tends to be regarded as the better, despite its greater complexity and the risk that it is harder for non-specialists to grasp.

The coverage of expenditure rule varies, with a tendency to exclude obvious cyclical components and interest payments. One of the experts interviewed, in a subsequent written submission, observes that ‘there is some trade-off between exclusion from the expenditure ceilings of not policy-related short-term influences and inclusion of sizeable buffers within the ceilings. At the same time there is also a trade-off between exclusions of various influences from the expenditure ceilings and the overall transparency and potentially ownership of the framework’.

The optimal approach to treatment of revenues, especially if they are windfalls, is also of interest. One relevant contention is that the government has less immediate control of revenues, especially if the tax system is stable, whereas it directly controls expenditure. For this reason, the focus in the four European comparator countries is on controlling expenditure without allowing the ceiling to be altered if revenue changes. One open question is whether to allow at least some change in expenditure in response to

revenue changes, especially if they are large, as they might be in periods of inflation when fiscal drag may boost tax receipts.

3.3 Scrutiny, transparency and accountability

That effective scrutiny enhances the quality of fiscal policy might be considered a statement of the obvious. However, the evidence from the interviews suggests that the mechanisms through which the government is scrutinised can make a difference. As discussed further below, bodies truly independent of government are most desirable and transparency is a valuable tool. Moreover, although it can be uncomfortable for finance ministries, the benefits from effective scrutiny are likely to be reinforced where the media make use of reports from independent fiscal institutions. The IMF now strongly advocates effective IFIs, although New Zealand, where the word ‘transparency’ is at the forefront of its framework, has so far opted to do without one. Instead, they emphasise the importance of transparent and extensive reporting of public finances.

Consensus within a country on the goals of a fiscal framework complements scrutiny. It undoubtedly helps if voters, perhaps also financial markets, have faith in the importance and effectiveness of arrangements for managing and overseeing fiscal policy. A respected IFI also helps, including by fostering the taking of ‘ownership’ by the national authorities. Independent scrutiny of fiscal policy and macroeconomic forecasts is important in how it obliges governments, to borrow an expression from one interviewee, to ‘up their game’, but accountability is also enhanced if the public and other stakeholders have confidence in how the IFI assesses government actions and choices. The CPB in the Netherlands has had this status for decades, as has the Danish IFI, but the Swedish and Irish IFIs are examples of more recently created entities that have quickly gained credibility.

In addition, as mentioned earlier, rigid frameworks with strict stipulations and sanctions are unlikely to be as effective as the reputational threat to the government of being seen to ignore well-founded analyses or having to change spending plans agreed by the national parliament. An interesting example is in Sweden, where it is open to the government to go back to the Riksdag to seek an increase in the expenditure ceiling. Yet, because of the political cost it would incur, the ceiling has been raised only a couple of times and it has yet to be exceeded in its 25 years of existence.

3.4 The longer term

A significant gap in many fiscal frameworks is the limited attention paid to long run fiscal sustainability, although the indications are that it is an aspect of framework attracting increasing attention. There are only few countries (Denmark is an example) that use a calculation method for the budget balance that is in accordance with long-term fiscal sustainability.

There are divergent views on how useful a debt anchor can be, notably in focusing attention on future objectives. An evident difficulty is that a binding target can lead to inappropriate, possibly pro-cyclical policies, as might happen if a downturn in an economy already close to a threshold required fiscal tightening. Sweden's answer is to conceive of the debt anchor as a device to influence the medium- and longer-term conduct of policy, but not to let it have an undue influence on annual decisions. However, in light of the November 2022 proposal by the EU to emphasise debt sustainability – and its analysis – in a reformed EU system, debt targets (or target ranges) may become more necessary. There is also inherent uncertainty in any sustainability calculations (for example, what is the long-term cost of climate change?).

A related Issue is the targeting of the fiscal balance. Countering climate change and ageing are examples of policy objectives expected to require increased public spending in future, implying that efforts should be made in the present to build up budgetary resilience. In relation to ageing, provisions for pensions, especially, but also other age-related spending can be overlooked as a key part of the fiscal framework from two opposed perspective. The first is estimating future liabilities and ensuring that there is a sustainable path towards meeting the 'pay-as-you-go' component of them. At the same time, funded pensions are a source of financing for long-term infrastructure projects, a point emphasised by the Dutch interviewees.

It is vital to link well-defined long-term targets and the medium-term targets. A consensus approach to the linking of long- and medium-term targets is that there should be (1) a broad prescription of the sustainability of public finance, and (2) a (medium-term) path towards the sustainability goal. Sustainability is an elastic concept, and relates not only to public finances, but also to the successful of reforms and broad policy objectives (for example the green transition), as well as welfare and intergenerational fairness.

Among the comparator countries there are different approaches to linking medium-term and the long-term targets, some more prescriptive than others:

- ... *Denmark*: the current long-term fiscal strategy is to ensure sustainability of pensions and other current public spending. The aim is to achieve this by setting a medium-term target consistent herewith (while also keeping the annual structural budget balance below a -1% of GDP limit). The argument is that moderate deficits are reasonable to run as real growth and inflation keep the debt stable. This target has been built on long-term forecasts of the demographics and long-term steady state assumptions on public consumption and taxes.
- ... *Ireland*: The recent addition of a nominal spending increase cap based on medium- to long-term calculations of fiscal sustainability bolstered medium-term planning, but the framework is still lacking in distinctive long-term targets and tools. The nominal spending increase cap is yet to be legislated. Ireland is also considering diverting windfall tax revenues from multinationals into a rainy-day fund.
- ... *Netherlands*: There is no clear link between medium-term budgeting practices and the long-term, but the Dutch have invested heavily into large public funds ranging from investment funds to pension funds.
- ... *New Zealand*: has a surplus target for the operating budget balance before gains and losses that is compared to the costs of population aging, not least growing demand for the health sector. There is no explicit procedure to adjust the target mid-term in case of sustainability problems, but each new Government can set its own targets as they wish. New Zealand also protects public investment with an approach that approximates to a golden rule, albeit without being explicitly such a rule.
- ... *Sweden*: there is a formal 35% Maastricht debt-to-GDP anchor and a surplus target of one-third of a percentage of GDP on average over a business cycle for the entire general government sector. There is also a clear link between the short- and medium-term, because of how the surplus target connects with the debt anchor. The long-term plans and fiscal tools are revised every other electoral period to reflect the current and future state of fiscal sustainability.

3.5 Flexibility

Providing sufficient flexibility during crises is widely regarded as an important feature of fiscal frameworks. It is necessary to avoid situations where circumstances beyond the control of the government put unrealistic pressure on the adjustments of fiscal policy. However, a difficulty in balancing fiscal flexibility and sustainability has emerged, as countries have experienced a large and continuous build-up of debt over time (Davoodi et al., 2022; Caselli et al., 2022).

A key development over the last decades has been the introduction of so-called trend-based budgetary ceilings, as discussed above. They exclude factors adding to expenditure but outside the direct scope of fiscal policy from the ceilings and form the basis of the “second generation” of fiscal rules (Eyraud et al., 2018). These influences on expenditure typically include the cost of inflation, unemployment expenditures and interest on public debt. Most prominently, this development is reflected in the EU's expenditure rule, which has been based on monitoring the growth of public expenditure relative to a country's potential output growth (European Commission, 2019). Trend-based models, applied by several of the comparator countries (Finland, Ireland, Denmark and the Netherlands), are also recommended by the IMF (Caselli et al., 2022).

The Swedish model, on the other hand, provides an interesting alternative. Only few items are removed from the ceilings, while the purpose of the framework is merely to control for major policy errors. Such a framework is simple, but it also places greater emphasis on (unallocated) expenditure buffers and/or the cooperation between parliaments and governments in the event of major expenditure or revenue surprises. By comparison, a trend-based system is technically more precise and can guide government policy without the need to change the framework in crises. On the other hand, its application is more complex, which makes it more difficult to communicate and monitor the framework.

Based on the interviews, there is no clear ranking between different forms of implementation, but the functioning of the framework largely depends on the political culture of the countries. All the framework models examined (the Netherlands, Sweden, Denmark, Ireland and New Zealand) have recently succeeded in their steering role. This confirms the earlier finding that very different systems can therefore work, which underlines the fact that reactions to shocks are political decisions that are ultimately the responsibility of governments. The success of the rules depends on how the frameworks are combined with the political culture of each country.

3.6 Public investment

A recurring challenge in managing public finances is how to ensure that public investment is protected, especially in periods of fiscal tightening, when it is often easier to cut than public consumption. For the most part, the interviewees were sceptical about resort to some variation on a golden rule, although the manner in which operating (i.e. current) expenditures and revenues are governed in the New Zealand system, with different provisions for investment, has golden-rule features. Obvious objections include the difficulty of defining investment and the risk of lobbying for inclusion of a disproportionate range of public spending commitments. At the same time, climate change and other underlying societal objectives need to be accommodated.

The main alternative, visible in some of the comparator countries, is to develop a coherent medium-term investment strategy, allied to analyses of medium-term fiscal developments. A suggestion from one interviewee is to use 'green budgeting techniques to collect information on and give visibility to the relationship between budgetary policies and environmental objectives.

The interviews and literature also highlighted the importance of external control of investments, which is considered to have a material impact on their quality. It improves decision-making and long-term planning. Various options for managing both public and publicly supported investments are in place. In the Netherlands, for example, investment funds are used, while in many other countries, investment decisions are guided by expert boards. Due to the public good nature of green investments, arguments have also been put forward for supranational climate funds, although resort to them could lead to clashes between national sovereignty and supranational control.

3.7 Escape clauses

The pandemic led to unprecedented deviations across the world of public deficits and debt-to-GDP ratios from fiscal rules in 2020-2021 (Davoodi et al., 2022). Around 90% of countries with a deficit rule exceeded its limits in 2020, with a median positive deviation of around 4% of GDP. More than half of the countries with the debt rule had debt above the threshold level, with a median deviation of 50% of GDP in advanced economies, and 26% of GDP in emerging markets and emerging economies.

Use of escape clauses has been a prominent way to provide additional flexibility during the corona crisis period. While it gave fiscal leeway to respond to the health crisis, the use of escape clauses represents a difficult trade-off between creating room for manoeuvre in economic policy, on the one hand, and risking longer-term sustainability

of public finances on the other. Information from the interviews revealed differing approaches to the use of the escape clauses, but in general they are considered to be a good feature of the system (see also, Blanchard et al., 2021; Caselli et al., 2022; Davoodi et al., 2022).

The formulation of the clauses is essential to their success. However, it can be difficult to set precise numerical rules for use, as large shocks are unpredictable, and the associated numerical values are easily politicized. Especially in countries with strong institutions, focusing on the qualitative description of trigger definitions (or even a procedure without a specific clause in the case of Sweden) may be a better option than setting numerical limits. The definition of extraordinary circumstances to justify triggering the general escape clause of the Stability and Growth Pact was cited by several interviewees as possible model. However, it is noteworthy that it could only be used in the event of major disruptions affecting the entire European Union. The optimal compromise between flexibility and limiting debt risk is likely to require greater discretion (Blanchard et al., 2021).

4 Governance features of frameworks

Although the findings of this study do not suggest there is an optimal model for a fiscal framework, there are several features that can contribute to a robust and resilient approach. In one of its many publications on good governance of fiscal policy, the OECD sets out ten principles for success. They are set out in the box below and some of them provide a checklist for identifying characteristics associated with sound fiscal policy.

BOX 2: PRINCIPLES FOR SOUND FISCAL FRAMEWORKS, ACCORDING TO THE OECD

1. Manage budgets within clear, credible and predictable limits for fiscal policy.
2. Closely align budgets with the medium-term strategic priorities of government.
3. Design the capital budgeting framework in order to meet national development needs in a cost-effective and coherent manner.
4. Ensure that budget documents and data are open, transparent and accessible.
5. Provide for an inclusive, participative and realistic debate on budgetary choices.
6. Present a comprehensive, accurate and reliable account of the public finances.
7. Actively plan, manage and monitor budget execution.
8. Ensure that performance, evaluation and value for money are integral to the budget process.
9. Identify, assess and manage prudently longer-term sustainability and other fiscal risks.
10. Promote the integrity and quality of budgetary forecasts, fiscal plans and budgetary implementation through rigorous quality assurance including independent audit.

Source: OECD (2015) 'Recommendation of the Council on Budgetary Governance', Paris, OECD, [Principles of Budgetary Governance— OECD](#)

Although these kinds of principles can be regarded objectively as desirable, they have to take account of the history, institutional make-up and culture of a country. Past crises, traditions in fiscal policy (often derived from ideologies), the powers conferred

constitutionally on sub-national governments and the relationships with other agencies responsible for macroeconomic management (not least the monetary authority) are all salient. They are bound, also, to influence the scope for reform of the fiscal framework and the overall approach to economic governance.

Nevertheless, the extent of adherence to the OECD principles can be instructive. Thus, in all the comparators, the alignment of budgets with government medium term priorities is evident, being shaped by the manner in which expenditure rules are implemented. Similarly, one of the most compelling findings of the comparative research is the importance of having robust and independent scrutiny of fiscal policy. How this is achieved varies among the countries studied, but the point was made forcefully by interviewees. Parliaments do have an influence, but it tends to be on the biggest decisions and there is some suggestion that from a day-to-day perspective, parliamentary scrutiny is less important.

4.1 Governance of scrutiny and decision-making

Well established and supported IFIs are crucial, but even then, there can be variations in the mandates of these bodies. A point made by some interviewees is that the talent pool is a factor to take into account in choosing how ambitious or extensive the role of the IFI should be, especially in smaller countries. The IFI should, nevertheless, be strongly encouraged to have good media engagement. However, it is important to distinguish between the challenges of resourcing an IFI, on the one hand, and conferring tasks and independence on it, on the other. In the three comparator economies with similar sized economies (DK, IE and SE), ensuring the independence of the IFI is paramount and scarcity of experts does not detract from this aim. Ireland's solution is to broaden the talent pool by being prepared to appoint non-nationals as members of its fiscal council. In the Netherlands, the CPB has a much broader remit and has been able to recruit sufficient talent.

The order in which decisions on expenditure are taken can influence the credibility of expenditure ceiling. In this regard, setting the aggregate in a first vote, as in Sweden, and then having a second vote on the allocations among departments, appears to strengthen the expenditure rule. In Ireland, separate Finance and Expenditure Departments is another approach.

Although awareness of the need to pay attention to the quality of public finances (often interpreted to mean how public spending affects growth potential or the realisation of goals such as the green transition, implicit in rule 3 as set out in the box, above) is widespread, some interviewees suggested it was not a prominent consideration. More

generally, while more attention is being paid to the longer term, it is an aspect of frameworks that could be improved.

Changing ceilings is a delicate issue. Their strength and, indeed, their underlying rationale is to establish an agreed pathway for public expenditure which should not be modified without a compelling reason, such as a significant economic shock. If an adjustment is, instead, proposed for political reasons, it risks undermining the disciplining effect of an expenditure rule. As one interviewee put it:

“It is a major problem when the size of the overall budget is opened for discussion in the middle of the parliamentary term”.

That said, a shock of the magnitude of the Covid-19 pandemic calls for exceptional policy responses, and thus the need for a degree of flexibility in the fiscal framework. In all the comparator countries, emergency programmes were put in place, outside the expenditure rules, although it worth noting that doing so was facilitated by the robust fiscal position achieved previously. The design of COVID measures was largely ad hoc, although most have aged well in terms of the economic recovery, avoidance of scarring in the labour market and lack of lock-in effects.

What is more problematic is the ‘return to normal’. It can be difficult to maintain a high quality of public finances when the primary purpose of exceptional funding is stimulation of aggregate demand. Moreover, when a new expenditure rule and cost-of-living measures are introduced after the crisis, there is still pressure to design them quickly (in weeks or even days), possibly leading to poor design and targeting. Striking a balance between fiscal and structural policies can be difficult. In an economy with well-functioning structures, there may be less need for fiscal stimulus during major crises because resilience is already built in.

4.2 The influence of supranational obligations

The influence of EU rules and how it may change as a result of the November 2022 proposal from the Commission varies among the comparator countries. For the two participating in the Euro (Ireland and the Netherlands), EU fiscal rules have some salience, but they are not at the centre of the fiscal framework, even though for Ireland, in particular, they influenced the reforms introduced after the 2010 bail-out. In the Netherlands, despite a formal duty of the Council of State to monitor compliance with EU rules, the message from interviewees was that as part of the “trend-based” fiscal framework, the expenditure and revenue ceilings are translated to the norms applicable under the SGP. These ceilings could provide stricter or looser application than

SGP requirements, but if so, are translated transparently. For Sweden, EU rules are much further in the background and of little consequence. In Denmark, as a member of the ERM II and thus with an exchange-rate target for monetary policy (unlike Sweden), there is an enhanced reason for fiscal discipline. Rules for the annual structural budget balance as well as possibilities for deviating from that limit in exceptional circumstances have been explicitly designed to comply with and incorporate EU rules.

Nearly all the interviewees who commented on them believe key features of the proposed new Commission approach will be improvements. In particular, a shift to country-specific arrangements is welcome. However, the perseverance with the 3% and 60% rules attracted criticism.

5 Possible implications for reforming the Finnish fiscal framework

While caution always has to be exercised in transplanting a mechanism or practice from one national setting to another, the findings of the report point to several possible reforms for the Finnish framework. This report is a part of a wider project for the Finnish Government's analysis, assessment and research activities (VN TEAS) tasked with assessing the needs for reform of the Finnish fiscal framework. On top of this comparative report, the project consists of a Finnish report¹² specifically examining the Finnish framework. Some orientations for reform have also been set out in the Finnish report, but a number of others can be derived from the experience of other countries as laid out in this report.

5.1 Technical changes

Four main areas in which there are opportunities for change are considered in this sub-section: flexibility and responses to shocks; long-term goals; how to deal with the revenue side, especially windfall revenue gains; and the approach to public investment.

Flexibility, notably in dealing with shocks

A trend-based expenditure ceiling is at the core of the Finnish fiscal policy framework. The purpose of the system is to guide the making of expenditure decisions by setting an expenditure constraint within the framework, which is jointly agreed between the government parties. The principal advantage of trend-based ceilings is that they allow public finances to comply with fiscal rules regardless of short-term surprises in public finances, as their impacts are excluded from the ceilings. This makes the system more complicated, but can make the steering role of the framework more precise.

Since the 1990s when the ceiling was introduced, the Finnish system has mostly been applied with success. It has been respected by governments, but it has not prevented a gradual increase in the general government debt-to-GDP ratio since the onset of the global financial crisis in 2008. During the crises of recent years, there were sizeable deviations from the spending ceilings. While this has given room for flexibility, it is not

¹² Suomen finanssipolitiikan sääntökehikon toiminta ja kehittämistarpeet (Kuusi et al., 2023).

without problems. Specifically, the control mechanism loses its effect if it is not respected. Simply put, if there is no real commitment to adhere to the mechanism, it can be harder to defend why the more complicated, trend-based spending ceiling is used, instead of a simple ceiling as in Sweden. Indeed, there is a danger of it becoming a watered-down version of the complex technical model in which the rule is supplanted by discretion. If this happens, trust in the integrity of implementation of the technical rules risks being lost, yet the political system will not have adapted to discretionary policy either.

Thus, a key objective of the Finnish reform should be to clarify its operating model. The response to crises must be divided into the *modus operandi* of normal economic cycles and exceptional crises. In the case of normal economic cycles, the flexibility provided by automatic stabilisers and unallocated reserves built into the framework should give sufficient room for fiscal policy. An exceptional crisis, on the other hand, means that the framework will be suspended by using a well-defined escape clause.

Longer-term goals and challenges

There is a growing concern in many countries about how best to integrate the longer term into fiscal frameworks, and the evidence from the comparator countries suggests Finland may be lagging behind in this respect. To redress matters, it would be useful for Finland to have a regular and formal review of the long-term sustainability of its fiscal policy, and on the basis of the review, to set clear medium-term objectives for fiscal policy. By providing a broad perspective on the different sustainability aspects and using independent experts, the report could both clarify the discussions and seek for political commitment to fiscal objectives.

Such an assessment should be carried out separately from the EU framework. It can be expected that the domestic target would be stricter than the supranational target. A possible means of doing so, could be to set a medium-term target for the general government budgetary balance on the basis of the long-term sustainability review. It would enable fiscal policy objectives as a whole to be set, while also fixing the objectives of the revenue side of public finances for the parliamentary term alongside the expenditure ceiling.

In Sweden, for example, a sustainability analysis is carried out every 8 years. Also, Caselli et al. (2022) recommend regular reviews of the framework, for example every five years or after major shocks. In this way, the effectiveness and relevance of the framework at different points in time can be ensured, without having to define them too generally or, on the other hand, in too much detail to be credible. Given the uncertainty, the target levels should have sufficient buffers in relation to the sustainability

limits. The experience of recent years has shown that the buffers may have to be quite large.

As the target would be set for the medium term, it need not be defined in structural terms based on difficult-to-implement estimates of potential growth or by relying on indicators of output gaps that are not directly measurable. Over the time horizon of the target, the current cyclical situation can be assumed to have normalised without further shocks.

Revenue issues

Different factors must be weighed when considering how to take changes on the revenue side into account in the application of the expenditure rule. One possible solution, drawing on the EU spending rule (measuring expenditure net of discretionary policy changes) is not optimal for Finland. In countries with developed public finances, such as Finland, the income side is broadly stable and thus its management may also be based on fewer rates of change in income policy. Indeed, in the comparator countries studied, the separation between income and expenditure in the fiscal framework is typically stricter than in the EU expenditure rule.

The conclusion to be drawn is that total tax revenues, discretionary tax measures and tax subsidies should not be included in the expenditure ceilings in a country like Finland. Therefore, in principle, the domestic expenditure framework should keep the revenue and expenditure sides strictly separated. Specifically, it should not be possible to compensate higher expenditure growth with (even discretionary) revenue measures during the parliamentary terms.

However, the distinction does not necessarily have to be categorical. For example, in Denmark, larger-scale revenue measures may allow adjustments of the expenditure ceilings. In Ireland, on the other hand, the EU spending rule, which is measured on a net expenditure growth basis, has been used to guide policy, although the COVID-19 crisis has led to a greater shift to the domestic spending rule.

In some situations, similar exceptions could be considered in Finland. In particular, the financing of recent defence procurements shows that there may be a need to improve the system. If the Finnish public finances are subject to large, long-term and exogenous expenditure shocks, off-setting them through discretionary revenue policy measures, without breaching the ceiling, could be envisaged. It could open the possibility of keeping such expenditure within the framework and, in parallel, of encouraging the raising of revenue.

Investment

With the exception of New Zealand, which has a distinctive approach to public investment, the findings from the interviews do not favour the introduction in Finland of some form of golden rule, separating public consumption from public investment. Similarly, the European Commission's (2022) communication regarding the reform of the EU fiscal rules, offers no support for a golden rule. Objections are well-known, and include problems such as creative accounting, misclassification of expenditures and arbitrary weighting of public policy objectives. Instead, the Commission encourages reforms so that debt accumulated in public investment would have a smaller impact on the medium-term expenditure rule than debt accumulated for other reasons.

An alternative, drawing on recent literature and the views of the experts interviewed is to opt for a comprehensive investment strategy that would be consistent with the overall fiscal framework in Finland. Green investment should be supported, but as part of a package that at the same time would ensure that the private sector is involved in the efforts, and that the use of public investment is weighted against the use of taxation and regulation to achieve green policy targets through enhancing private sector incentives. There is also a need for broader green budgeting, involving not only using fiscal policy instruments to achieve environmental objectives, but also assessing the environmental impact of budgetary and fiscal policies, and assessing their consistency in meeting national and international commitments (Caselli et al., 2022).

5.2 Governance and institutional reforms

The diversity of mechanisms and procedures in the five comparator countries provides a wealth of examples of the potential for change in Finland. These are covered under four main headings: transparency, independent scrutiny, decision-making processes and institutional innovation.

Transparency

There is broad agreement that more extensive transparency is conducive to better fiscal policy, raising two main questions. The first is whether there could be greater transparency in how fiscal policy is debated, decided and implemented in Finland. Availability of all relevant documents is only part of the answer because it can be thought of as 'passive' in the sense that while access to documents is not limited, they can be difficult to follow for the uninitiated or inexperienced. There is no magic formula for how to boost transparency, but 'active' transparency could involve greater efforts by governments to explain and to engage with other stakeholders, perhaps drawing on

practices in New Zealand and the Netherlands. The upcoming negotiations of the programme of the next coalition could be an opportunity to experiment.

The second question concerns medium- and longer-term fiscal choices. Whether for voters or decision-makers, future risks and opportunities are difficult to conceptualise, let alone debate. Studies on topics as diverse as climate change or ageing (for example in the Netherlands, by the CPB) provide information to experts, but can be difficult for non-specialists to understand. Information campaigns aimed at stimulating debate on aspects of fiscal policy beyond the immediate choices that dominate political discourse may be a solution to consider.

Independent scrutiny

Strengthening independent scrutiny of fiscal policy is among the EU proposals, published in November 2022, for a reform of fiscal governance. The existing provisions (the Audit Office and the Economic Council) monitor Finnish fiscal policy well enough and, in response to an OECD (2020) review of how the IFI function is fulfilled, the section of the Audit Office responsible had its independence reinforced. Nevertheless, Finland remains something of an outlier and the rationale for embodying the IFI function within the Audit Office is unclear.

A fully independent IFI would enhance scrutiny by providing a still greater degree of independence and, potentially, contribute to more media engagement. Interviewees repeatedly stressed the value of a visible IFI and in four of the comparator countries, it is clear that the media do make substantial use of the reports and opinions of the IFIs and that the government does ‘up its game’ as a result. It would also have the potential to contribute to greater transparency, including through being perceived as a watchdog able to bite as well as bark, without the possible risk of being reined in by the other obligations an Audit Office has to fulfil.

The decision-making process

A third area for reconsideration is the order of decision-making in the negotiation of the Finnish expenditure ceiling. Setting an aggregate expenditure ceiling in a first stage and only subsequently deciding on departmental spending allocation, as in Sweden, would be a means of separating the macroeconomic dimension from the more political aspects of expenditure priorities. Altering the decision-making sequence should be related to other proposals in this report. When more explicit planning for the longer term and for public investment in the widest sense is made, the order of decision-making may become important in securing these targets.

Institutional innovation

As noted above in relation to public investment, there are approaches adopted elsewhere which might be worth considering for Finland. One example is the recently established New Zealand Infrastructure Commission (described in section 3.4, above) which operates at arm's length from government. Having a body which is able to bring together public and private actors, and to have a broader overview of investment needs could facilitate better choices.

Annex 1: Reports on the five comparator countries

Denmark

In the early 1980s, Denmark endured a series of crises, with high unemployment, external imbalance, problems in the housing and construction markets and, later in the decade, difficulties in the banking sector. Wide-ranging reforms were introduced, aimed at promoting a more stability orientated macroeconomic policy. A key early decision was to keep the exchange rate stable (in contrast to Sweden), and the krone has since remained pegged to the euro through Danish participation in the exchange rate mechanism. Another key stabilizing feature is the automatic stabilizers, which are among the largest in the EU (Mohl et al., 2019).

Over time, the very high share of public expenditure in GDP – around two-thirds of which was spent by sub-national levels of government – has been reduced from its high point of just under 62% of GDP in the early 1990s to just under 50% prior to the pandemic. Fiscal policy was constrained by medium-term expenditure plans agreed by governments, usually coalitions, but as the 2013 OECD Survey of the country notes, ‘government had long failed to keep public expenditure in check, especially public consumption at local level’. On average, the annual overruns were 1.5% in 1993–1999 and 1% in 2000–2010 (Nielsen & Rasmussen, 2012). This was happening despite a 2001 agreement to a nominal “tax freeze” that effectively meant that taxes could not be raised – including at the local government level (OECD, 2013). Even before the 2008 financial crisis, such public expenditure management would not have been sustainable in the long run. One of the main reasons for these overruns was the lack of enforceable sanctions on municipal governments.

To deal with these problems, in 2012 the Danish Government enacted a Budget Law aimed at putting the emphasis on better spending control while also setting an annual limit for the structural deficit. The Budget Law introduced a structural budget balance and binding multiannual expenditure ceilings for central government, municipalities and regions (starting from 2014), as key measures. According to Lobe Suenson et al. (2016) the adoption of the 2012 budget law ‘was probably the most important public spending act ever. They go on to say it ‘was adopted in order to break with 35 years of budget overruns which had resulted in comparatively high public spending growth’.

From then on, fiscal policy was to be planned such that the annual structural budget balance would not exceed a deficit of 0.5% of GDP at the time of the budget proposal for a given fiscal year, unless there were extraordinary circumstances (Ministry of Finance, 2021). The lower limit of the structural deficit was revised in March 2022 and subsequently lowered to 1% of GDP, effective from 1st July 2022 (Ministry of Finance, 2022). The move was backed unanimously by all parties, and supported by practitioners, as well as the Danish Economic Councils. With this move, and in line with the long-standing strategy of preparing for demographic challenges, public finances were allowed more breathing room to deal with headwinds in the coming decades, while keeping debt-to-GDP low.

The introduction of the Budget Law, effective in 2014, took place at a time when the economy had started to recover. GDP rose 16.0% from 2012 to 2019 and 'Maastricht' debt fell from 44.9% of GDP in 2012 to 33.6% of GDP in 2019 (Eurostat, 2022 & World Bank, 2022). Structural balance was achieved during the first four years after the act (2013–2016), with an average deficit of 0.3%, though with some volatility, and a surplus of an average 2.2% was achieved during the next three years (2017–2019) (Eurostat, 2022). The general government indicators were, consequently, very favourable prior to the pandemic, affording substantial fiscal space for responding the exceptional circumstance of 2020.

The Danish expenditure ceilings (the latest, for the period up to 2026 was published by the Finance Ministry in 2022¹³) are designed to support compliance with the overall medium-term fiscal policy objectives. They set legally binding limits for expenditures in central government, municipalities and regions, respectively: two sub ceilings for central government (operating expenditure and income transfers), two for regions (healthcare and regional development) and one for municipalities (net operating expenditure) (Sherwood, 2015). The ceiling levels are set to be permanent, but they can be altered in case of an election or a major structural reform. However, the guiding principle is that they are not to be raised unless proper funding has first been found and adopted.

Within these ceilings, these levels of government maintain their autonomy in determining allocation of spending (OECD, 2019). The ceilings cover four years added on a rolling basis, and they can be adjusted in specific circumstances. They are set in real terms, but are converted to nominal terms when annual budgets are made for the coming fiscal year. The ceilings exclude interest payments, unemployment benefits and investment. Discretionary increases in expenditure related to e.g. unemployment are allowed if counterbalanced by decreases of the expenditure ceiling elsewhere

¹³ [2030-planforløb: Grundlag for udgiftslofter 2026 \(fm.dk\)](#)

(Manescu & Bova, 2020). In total, the ceilings cover around 75% of public expenditure.

Danish fiscal balance rules are stricter than required by the Stability and Growth Pact (SGP) or the Fiscal Compact which Denmark had signed in 2011. It can, however, be put in the corrective arm of the SGP, obliging the government to act under the Excessive Deficit Procedure (EDP) to conform to the SGP rules. Denmark was required to report under the EDP between 2010–2013. In 2012 it breached the 3% of GDP deficit limit. The EU fiscal compact was incorporated into Danish legislation through the Budget Law. In their own structural budget balance calculations, they put more emphasis than the EU on observable variables, such as indicators of capacity utilization. The Law also stipulates that measures must be taken to correct a significant deviation from the MTO or the adjustment path to it. A deviation is regarded as significant if it exceeds 0.5% of GDP. The correction measures must amount to an improvement of at least 0.5% of GDP in the subsequent fiscal year (Calmfors, 2020).

When it comes to abiding by the debt-to-GDP ratio limit, Denmark has a legally grounded debt limit, albeit at a level so far above the present levels of debt that it has never been a constraint on government. The updated limit stands at 2 trillion Danish krone.¹⁴ As of 2021, but public debt was a mere 0.9 trillion Danish krone or 36.7% of GDP. Despite the seeming lack of interest in the debt limit, the Danes still give considerable attention to long-term forecasting, several decades in the future. These projections are, however, focused on retaining sound public finances rather than a steady debt level. Sophisticated calculations of demographic changes (in relation to which the Danes are pioneers) are central to these projections.

Active involvement of parliaments in budget matters is said to increase political commitment to them and Denmark has adopted extensive parliamentary engagement in the process (Sherwood, 2015). According to the Budget Law, the ceilings are to be approved by the Danish Parliament (Folketinget) in a majority vote. The Folketinget has unrestricted powers to amend the budget and expert staff of the Budget Committee are available to parliamentarians for specialist advice (OECD, 2019). However, the calculations by the Ministry of Finance appear to be widely accepted and are thus rarely challenged, even across party lines. This consensus on the framework and its intentions is also broadly accepted by the wider public.

In addition, the Danish Economic Councils (in the plural, because the original economic council, established in 1962, was complemented in 2007 by a second council focusing on environmental questions) acts as a fiscal watchdog. It assesses long-term

¹⁴ LBK nr 849 af 22/06/2010

fiscal sustainability and the medium-term development of the budget balance, and further that the expenditure ceilings are complied with and align with the medium-term fiscal objectives. The Economic Council members represent a variety of economic stakeholders and enjoys very high credibility.

Its core is the four independent members of its “Chairmanship” commonly referred to as ‘The Economic Wise Men’ (one of whom is currently a woman!) (Kærgård & Andersen, 2021). Although the members are formally appointed by the Ministry of Finance (MoF), it is the incumbent chairmanship who by tradition nominates its new members. Holders of the post have been highly respected academics. The independence of its members and the Secretariat is generally not questioned in practice.

The Economic Council produces reports containing economic analyses and policy recommendations on general economic policy as well as a short- and medium-term forecasts of key data on the Danish economy. These reports gain wide media coverage. The Chairmanship of the Council is solely responsible for choosing topics and methods for the reports as well as concluding them. Lastly, it is charged with assessing the methods used by the Danish ministries in the preparation of ex-ante assessments of the dynamic (i.e. behavioural) effects of economic policy measures.

Denmark has very stringent stipulations regarding how the government, regions and municipalities must respond to breaches of the ceilings. If the central government ceilings are not respected, the Minister responsible must implement corrective measures immediately. If this fails, the MoF shall reduce the ceiling of the following year by the appropriate amount. The MoF is obliged to exercise expenditure control both ex-ante and ex-post (Calmfors, 2020). If it finds an expected overspend for operating expenditure during the fiscal year, it must limit these expenditures by a corresponding amount. It must also limit expenditures for the following fiscal year by a corresponding amount to the realized overdraft for operating expenditure in the previous fiscal year.

Expenditure cuts can, however, be avoided if discretionary tax increases are made. Hence, the ex-ante and ex-post control of expenditure seems to function more to support the fiscal-balance target than to limit expenditures per se (Calmfors, 2020). For regions and municipalities, violations of the ceilings trigger sanctions in the form of reduction in grants from the central government.

For the structural balance, ex-ante deviations can arise from simple revisions of structural balance estimates, which is a frequent occurrence, and this could require policy adjustment when planning the fiscal bill for the coming year. Thus, the Council recommended that ex-ante deviations of at least 0.25% per year in two years should be allowed as they are in the Fiscal Compact (Calmfors, 2020).

The Danish fiscal framework can be described as a success. The expenditure ceilings, which have been in place since 2014, have never been exceeded. Recent years have not seen any budget overruns relative to budget plans, in sharp contrast to preceding decade. However, some have questioned whether the central government sub-ceiling for income transfers has been set so high that it has no real constraining effect (Calmfors, 2020). A conclusion reached by Lobe Suenson et al. (2016) is instructive and may hold lessons for others:

“Denmark has implemented reforms in areas that previously would have been very difficult to change, including early retirement, unemployment benefits, social welfare, and economic support for students. The economic crisis made otherwise very difficult reforms possible”.

The framework, though strict under normal circumstances, has ample flexibility for deviating from the regular framework surrounding fiscal and expenditure policy in extraordinary situations, such as the pandemic. During the pandemic, the ceilings were not formally exceeded, as COVID-19 related additional expenses were exempt from them between 2020–2021, and the deficit limit of the structural balance of the Budget Law was temporarily suspended as the Government deemed the situation to be extraordinary.

The Danish framework has undoubtedly worked as intended thus far. The pragmatic and forward-looking way of organizing their public finances will still leave the Danes in a good position to tackle these future challenges.

Ireland

In the period up to the mid-1980s, Ireland had seen its public finances deteriorate markedly. After the introduction of tough measures, macroeconomic stability was progressively restored, helping to usher in an extended period of growth, often referred to as the Celtic Tiger period. However, by the mid-2000s, imbalances in the economy were becoming accentuated, in large part as a result of lax oversight of lending by the banking sector for property investment. When these loans proved to be toxic for the banks, guarantees were offered by the government to deposit holders of the banks in difficulty. This precipitated a massive fiscal crisis culminating in the bailout from the EU, the IMF and others, agreed at the end of 2010, thereby avoiding a sovereign default.

Following major fiscal retrenchment, among the conditions applicable to the external support, Ireland introduced extensive structural economic reforms and broad-based budgetary reforms in the early 2010s (OECD, 2019). It was recognised that fiscal policy had been too pro-cyclical and also that there was insufficient independent scrutiny of the government policy stance (Lane, 2010). The Fiscal Responsibility Act (FRA) of 2012 was a crucial reform that sought to put the public finances on a more sustainable footing. Conforming to EU obligations, the Act established the Irish Fiscal Advisory Council (IFAC) as Ireland's budgetary watchdog and legislated for the implementation of national and EU fiscal rules. Since then, there have been further innovations in parliamentary engagement, including enhanced committee scrutiny and the establishment of an Irish Parliamentary Budget Office in 2017 (OECD, 2019).

The Irish framework puts great emphasis on limiting expenditure, achieving a budget surplus and lowering debt. An expenditure ceiling applies to almost all public spending (OECD, 2019). It is set for three years at a time on an annual rolling basis, and it is legally grounded in a manner consistent with both EU and national fiscal rules. Ceilings are adjusted each year (OECD, 2019). A budget balance requirement is imposed on local governments, although they have limited revenue-raising powers.

There is no formal vote on the budget, but rather an effective one that takes place through a vote on tax changes. For the budget, there is structured engagement by parliamentary committees, notably the budget oversight committee and public accounts committee, but the parliament has no power to amend, or recommend amendments, to budget proposals (OECD, 2019). Apart from the FRA, there is no formal legal framework for budgeting, but rather a combination of broad constitutional precepts, legislation in specific areas and established convention (OECD, 2019). In this sense, parliamentary engagement is not very strong.

Political commitment to the Irish system is not so much based on laws as it is on political scrutiny. With an economic crisis as severe as Ireland had to face in the period 2008-10, it is no wonder that politicians took such drastic budgetary action, and are disposed to abide by the fiscal and budgetary rules. If it fails to comply with the rules, the Government is required to implement a correction mechanism and introduce a plan to restore compliance (The Government of Ireland, 2013). Exceptional circumstances that would make these rules redundant are the same ones that would apply for the SGP (e.g., the pandemic).

The Irish Fiscal Advisory Council's mandate is to monitor and, once a year, provide an assessment of compliance with the Domestic Budgetary Rule set out in the Fiscal Responsibility Act. The last published assessment of compliance is from 2019 as fiscal rules were put on hold following the activation of the general escape clause due to the pandemic. However, according to Davoodi et al. (2022), IFAC did say that the COVID-

19 related social measures might have contributed to breaching the legislated limit and required the government to seek parliamentary approval.

Another element of the IFAC's mandate is to monitor, and twice a year, publish a fiscal assessment report on the Government's macroeconomic and budgetary forecasts, the appropriateness of the fiscal stance, and compliance with the budgetary rule, as well as detailing the Council's endorsement function. These reports continued to be submitted during the pandemic. In the latest report, submitted in November 2022, the IFAC criticized the Government for having only a three year horizon for expenditure ceilings, noted the risks associated with exceptional corporation tax revenues and warned about the need for better medium-term planning. IFAC also raised questions about plans for a *National Reserve Fund*.

The FRA of 2012 and 2013 placed the medium-term objectives (MTOs) of the reformed SGP and the Fiscal Compact on a statutory footing (The Government of Ireland, 2013). The structural budget was to be balanced or in surplus for general government. With its general government consolidated gross debt, or Maastricht debt, peaking in at 119.9% of GDP in 2013¹⁵, reducing the debt ratio to below 60% of GDP was of high importance as an objective to Ireland. The banking and sovereign debt crises caused Ireland's public finances to deteriorate so much that they were put into the corrective arm of the SGP and thus, required to balance their budget and lower their debt through an excessive deficit procedure (EDP). Ireland had an ongoing excessive deficit procedure between 2009–2016. Ireland made great strides since then reaching both targets by the end of the decade.

The handling of the pandemic was effective and fully supported by the IFAC. The Council endorsed every macroeconomic forecast prepared by the Department of Finance following the outbreak of the pandemic – though in 2022 it did criticize the Department for the shortened three-year forecast as opposed to the usual five-year requirement. IFAC has not yet produced a final opinion on how to reconcile covid-related expenditure with the national fiscal rules. However, according to IMF (2022:18), IFAC did say that the COVID-19 related social measures might have contributed to breaching the legislated limit and required the government to seek parliamentary approval.

In the Summer Economic Statement 2021, the Government introduced a new medium-term budgetary objective that was to maintain the level of expenditure ceilings fixed with a new nominal spending rule. According to this rule, the Government's

¹⁵ Their own calculations using the GNI* (gross national income tailored to include the effects of Ireland's unique economic activity) places public debt much higher than the Eurostat equivalent (Government of Ireland, 2023).

spending was allowed to increase by 5 per cent per annum in the post-pandemic years (The Government of Ireland, 2021), roughly split between 3 points of real growth and 2 points of inflation. This would tie expenditure growth to the estimated nominal growth rate of the economy until the mid-part of the decade to ensure that public finances remain on a sustainable path. IFAC (2022a), which had for many years argued in favour of implementing more credible spending rules, welcomed this new rule. In their May 2022 Fiscal Assessment Report, they note that the rule has worked in limiting spending as the Government had stuck to it.

The rising inflation rates of 2022 left the Government in a predicament in regard to the 5% target as there is no inflation adjuster in the spending rule. In Summer 2022, the Government raised the spending rule to 6.5% increase in 2023 with the plans to return to 5% increases in 2024 and 2025 (The Government of Ireland, 2022). IFAC (2022b) supported this move, stating that the rule has ‘proven to be simple and reasonably effective anchor’ and that it has ‘helped ensure more sustainable fiscal policy, while appropriately reframing fiscal policy in terms of the trade-offs involved’. The Council nevertheless recommends that the rule be reinforced by: putting it on a legislative basis; have it net out tax changes; having a link to debt targets; and be broadened to capture general government spending.

Leading up to the pandemic, Ireland had largely recovered from the trauma of the sovereign debt crisis which saw the Government budget deficit soar to 32.1% of GDP.¹⁶ ‘Maastricht’ debt quickly rose from 23.9% of GDP in 2007 all the way to 120.0% of GDP in 2013 (Eurostat, 2022). However, following the tough austerity measures, comprising a range of spending cuts and tax rises, started to take effect and the Irish economy began to recover from 2014 onwards. From outside looking in, the Irish framework seems to be working. How much of it is due to the framework and how much is from sheer will and trauma of the recent crisis is unclear. Ireland faces very distinctive technical challenges because of the large share of multinational corporation activity in its economy and tax revenues.

A recent surge in tax receipts illustrates the problem, because it notionally implied a massive surplus, posing problems of how to accommodate tax windfalls in the calculations of targets. Interviewees all drew attention to the misleading nature of ratios relating to GDP in appraising the sustainability of Irish fiscal policy. The data the Commission uses as their target simply do not present an accurate portrayal of the Irish economy. Ireland also struggles with how to measure structural adjustment of the public finances and regards the European Commission methodology as flawed. Alternative

¹⁶ For context, Greece’s budget deficit peaked at 15.1% of GDP in 2009 (Eurostat, 2022).

techniques are used, but because they are incompatible with the EU approach, EU monitoring is arguably less effective.

Netherlands

For many observers, the Dutch fiscal framework has long been regarded as among the best in the EU. Thus, an assessment for the OECD (Bos, 2008) commented that “the Dutch fiscal framework is in many respects unique and highly recommendable”. Moreover, it continued to lead the way (OECD, 2019: 219):

“The framework is seen as an essential tool for implementing political priorities, and performance budgeting has been refined over the years into an advanced model with heterogeneous indicators and feedback connections to policymaking”

The underlying principle of the Dutch budgetary framework is that budgetary policy should be trend-based, with a longer-term perspective (Vierke & Masselink, 2017). A medium-term budgetary planning horizon and trend-based fiscal policy have been in place in the Netherlands since the mid-1990s. One objective of the trend-based fiscal policy is to keep government expenditure in check as well as to allow it to fluctuate over the business cycle and thus have some flexibility. A key mechanism for keeping government expenditure in check is the fixed expenditure ceiling for the duration of the four-year government term. The expenditure ceiling, because it is widely debated and scrutinised, also contributes to budget transparency.

The Dutch four-year expenditure ceiling is divided into four aggregate sub-ceilings: central government, social security, health care and public investments. They are defined by a legally based coalition agreement. The four sectoral ceilings should, in theory, solve budgetary issues within their sector, but in practice, the extra expenditure on health has often been financed with surpluses from the other two ceilings (Bos, 2008). Distribution within the central government ceiling is set by line ministries, and then further by budget programmes. Spending and revenue issues should be solved within the lowest ceiling set, but if this is not possible, decision-making has to move one level up (Bos, 2008). All the expenditure limits are set in terms of real growth and adjusted annually for inflation.

They also set benchmarks for the revenue side. Both sides are clearly distinguished from one another. The frameworks rely heavily on macroeconomic forecasts generated by the Centraal Plan Bureau (CPB) a long-established entity which plays a pivotal role in the Dutch system), sustainability analyses and comments on fiscal policy and budgeting. The Finance Ministry does consider other Ministries' wishes, especially on social affairs and health care, but has the principal responsibility for the final calculations for the ceilings it produces.

The expenditure benchmark in principle, allows for higher expenditure growth if this is financed by revenue-increasing measures, however, new discretionary revenue-increasing measures cannot be used to finance expenditure in excess of the ceilings (Masselink & Vierke, 2017). If any setbacks against the ceilings arise, windfalls can be used to compensate for setbacks within that sector. They cannot be used to finance new expenditure. Revenue windfalls are used to reduce the deficit instead, which allows for a countercyclical automatic stabilisation in which deficits increase during economic downturn and decrease in good economic times (Fiscal Policy Audit Network, 2022).

The expenditure framework covers between 80–90% of general government expenditure (Fiscal Policy Audit Network, 2022). In line with the trend-based fiscal policy, cyclical unemployment benefits and interest expenditures are excluded from the framework. This means that windfalls are automatically used to lower the debt, but at the same time lower-than-expected revenues do not have to be compensated for.

The Dutch framework differs from many others in that it also has an income rule (or ceiling as some call it) for tax revenue. This means that tax policy measures for the Government term are set in stone unless an opposing measure is found elsewhere, and the change is set in motion first. While cyclical expenditure is excluded from the expenditure ceiling, it is included in the income ceiling thus, ensuring fiscal policy works counter-cyclically. Setbacks in tax income cannot be compensated for with revenue windfalls within the income ceiling. Setbacks do not immediately require intervention by reducing expenditure or increasing taxes (Bos, 2008).

The 2013 Sustainable Public Finances Act (Wet HOF) codified the basic elements of the Dutch trend-based fiscal policy already established, as well as obligations related to EU commitments, notably the SGP. It also expanded upon the monitoring of fiscal compliance. In 2010, before the Wet HOF was passed, the Netherlands was put in the corrective arm of the SGP and was required to report under the Excessive Deficit Procedure between 2010–2014. After targets were met, the annual budgetary process in the Netherlands has been more focused on the national expenditure ceilings and the deficit target at the end of the four-year government term than abiding by the MTO.

Therefore, meeting it is merely an outcome and not a target in the Netherlands (Masselink & Vierke, 2017).

The institutional make-up of the fiscal framework is critical, especially the role of key independent bodies. The Netherlands has two independent fiscal institutions monitoring and evaluating its fiscal policy: the CPB and the Advisory Division of the Council of State. The CPB role differs markedly from its counterparts in other EU countries, most of which have more limited mandates. It has a broad remit in producing forecasts, assessing policy initiatives, evaluating fiscal transparency, performing ex-ante and ex-post evaluation of fiscal policy, monitoring observance of fiscal rules, and evaluating fiscal sustainability. To ensure it manages all these tasks, the CPB employs over 150 staff. This is an order of magnitude greater than all its EU counterparts.

A distinctive feature of the CPB is that it evaluates – in a non-partisan manner – election manifestos of parliamentary parties before every parliamentary election. It assesses them on the impact of their political promises on key indicators such as the budget balance, debt sustainability, structural employment, and income inequality based on the medium-term outlook. This tradition further increases transparency and political commitment to the framework.

To ensure its independence and impartiality, the CPB refrains from making normative recommendations (van Veldhuizen, 2019). This means that while the CPB could rank fiscal policy proposals by their impact, it will not express its direct preference for any specific policy. This task is performed by the Advisory Division of the Council of State which also acts as the fiscal watchdog of the state. It often uses the CPB's forecasts and calculations to help it scrutinize the Government. The Wet HOF expanded its role to cover monitoring compliance with EU fiscal rules. This role is beefed up by the constitutional complexion that the Council of State advises the government and Parliament on legislation and (economic) governance and is one of the High Councils of State. Their independence is guaranteed in the Constitution and this ensures they are able to carry out their tasks independently of the government.

As a guide produced by the Dutch Finance Ministry (2013) stresses, “the importance of Netherlands Bureau for Economic Policy Analysis (CPB) should not be underestimated. Its role as an independent fiscal institute fits well in the Dutch tradition of consultation and coalition agreements. In addition, the CPB is an institute that analyses government policies, laying the groundwork for evidence-based policies”. For most other EU member states, an independent fiscal council is a recent innovation, prompted by EU-level reforms, but the CPB dates from immediately after World War II and was seen as providing a template for other countries.

Parliamentary engagement is strong as the budget must, by law, be presented to and accepted by first the lower house (House of Representatives) and then by the upper house (Senate). The House of Representatives can amend the budgets of individual ministries, but not the overall ceiling level. After the budget bill has been adopted by the House, it moves to the Senate, which can then only approve or reject a budget bill. The budget process is long and the scrutiny extensive, increasing the pressure to commit to the budget. From 2000 onwards, the government has had an obligation to explain annually any deviation from plans, although Beetsma et al. (2013) note that this attempt to boost transparency attracted relatively little attention.

In the period after exiting the EDP in the early 2010s and up to 2019, the Dutch governments had a strong track record of complying with the national fiscal rules and budget bills. The fiscal policy of the 2010s had created fiscal space to cope with possible shocks to public finances. The Government also reported that it had met the overall expenditure ceilings set at the start of every budgetary year. In 2019, however, the Government raised the expenditure ceiling that was set at the start of the government term (Fiscal Policy Audit Network, 2022). In 2018, the State Council noted that the Government covered the structural budgetary effects of the new policy with wind-fall benefits from social security and health care. The State Council questioned if this was in line with the principle that windfalls should not be used for new policies. (Fiscal Policy Audit Network, 2022).

The pandemic led to a historically large budget deficit, forcing the Government to take greater emergency and support measures than ever before to limit the impact of the crisis (The Government of the Netherlands, 2020). According to the Draft Budgetary Plan (2021), corona-related expenditure, which resulted in a negative budget balance and an increase in government debt, had not come at the expense of normal expenditure. Eurostat (2022) estimated that the deficit rose to 3.7% of GDP in 2020, before recovering to 2.5% of GDP in 2021. Compared with many other member states, the Dutch finances were barely outside the limits of the SGP, in any case suspended.

The COVID-19 pandemic required many new expenditure measures that were large in magnitude. Normally, these new measures should have been integrated into the existing expenditure ceilings set in 2017, but the Government decided to keep the corona-related expenditures outside of them because there was no justification for cutting regular expenditure to fund support packages. (Fiscal Policy Audit Network, 2022). Doing so avoided pro-cyclical expenditure cuts, making use of the room for manoeuvre within the expenditure benchmarks (The Government of the Netherlands, 2022).

The Dutch medium-term budgetary framework can be described as having been effective over the last decade, but a clear message from interviewees is that this does

not mean it could not be improved, especially in relation to longer-term fiscal sustainability. The CPB has calculated generational accounts in the Netherlands for 30 years, demonstrating that current budgetary arrangements on taxes and public expenditure on social security, education and health care in the Netherlands are not sustainable. Under unchanged policies, the aging population will lead to a sharp and structural increase in public expenditure and debt, in particular on state pensions and health care (Bos, 2008). To their credit, the state-funded pension fund ABP is among the largest in the world (WTW, 2022). To complement this, the retirement age is also directly linked to life expectancy (CBS, 2021).

Beetsma et al. (2013) conclude that Dutch “experience with ‘trend-based budgeting’ may provide some useful lessons for national budgetary reforms in other countries”. They also observe that the growth projections by the CPB “are on average unbiased”. Political factors, such as being in an election year, are shown to influence both plans and the implementation of fiscal policy.

The CPB model is not one that could easily be translated to other countries, because it both requires extensive financial and professional resources and because developing the cultural and political acceptability of such an agency is bound to be a slow process.

New Zealand

New Zealand has been an innovator in macroeconomic policy, both monetary and fiscal. When the Reserve Bank of New Zealand Act was passed in 1989, it formalised a significant change in the approach to monetary policy which, in effect, ushered in a central banking paradigm of inflation targeting, with the corollary of giving operational independence to central banks. Fiscal policy was recast in the same year with the passing of the Public Finance Act (PFA), and more comprehensively by the Fiscal Responsibility Act 1994 (FRA) and later amendments to these. The motivation for change was, according to Buckle (2018), ‘New Zealand’s history of continuous government budget deficits and increasing public debt since the mid-1970s. This history of poor fiscal management was considered to be a result of several compromising features of fiscal management’ which he sets out in detail. In a review in 2015, the OECD (2015) commended the ‘strong fiscal and monetary frameworks’ for their contribution to macroeconomic stability.

New Zealand is distinctive in the emphasis placed on transparency and accountability in its governance of fiscal policy. Its fiscal framework relies on a set of fiscal principles and disclosure of information rather than compliance with detailed rules set out in law (The Treasury, 2015). Fiscal sustainability has been of the highest importance to the New Zealand fiscal framework, although a 2013 amendment to the PFA broadened the definition of good fiscal policy to include principles to guide the application of fiscal policy for the purposes of economic stability and economic structure (see Barker, Buckle & St Clair, 2008 for an explanation of these roles). It also provided for more flexible funding to support results of efficient public financing as well as further strengthening required fiscal reporting.

The Government is legally required to declare publicly its medium-term fiscal objectives. These include the usual debt and operating balance targets as well as fiscal objectives on operating expenses, operating revenue and net worth. New Zealand is not bound by any international medium-term fiscal objectives, although it is subject to assessments, taken seriously according to interviewees, by the IMF and the OECD. The Government publishes a fiscal strategy setting out its short- (for a period of at least 3 years) and long-term (covering a period of at least 10 years) intentions and objectives alongside the annual budget process (OECD, 2019).

The Government is also legally required to publish its long-term objectives (for the next 10 years) for total operating expenses; total operating revenues; the balance between total operating expenses and total operating revenues; the level of total debt; and the level of total net worth. The legislation does not, however, specify the form of the targets. They are not required to be numerical. The specific fiscal indicators are chosen by each government themselves and have evolved over time. These objectives are based on fiscal projections spanning a ten-year period beyond the five-year forecast period. The Treasury also produces a long-term fiscal statement, at least every four years, based on the long-term fiscal projections spanning a 40-year period (OECD, 2019).

The latest debt target before the pandemic was to maintain net core Crown debt¹⁷ within a range of 15 per cent and 25 per cent of GDP (The Treasury, 2020). In Budget 2022, the New Zealand Government adopted a new net debt indicator alongside a

¹⁷ Conceptually different from 'Maastricht' gross debt, but New Zealand also has a favourable gross debt ratio: on the OECD definition it stood at 36% of GDP in 2019, barely a third of the OECD average.

new net debt limit of 30% of GDP.¹⁸ While higher than previously, such a change is in line with the provisions of the framework and remains at a comfortably sustainable level, despite the exceptional circumstance of the pandemic. Its purpose is to ensure New Zealand maintain an internationally low Government debt level while giving greater room for infrastructure investments.

Using the old measure of net debt (net core Crown debt), the debt ceiling is equivalent to approximately 50% of GDP. Simultaneously, the Government returned to seeking to maintain steady operating surpluses on average within a band of zero to two per-cent of GDP to provide a buffer against future adverse shocks. The intention is to ensure that operating expenditure does not add to the net-to-GDP ratio across an economic cycle (referred to as the golden rule approach). The additional debt headroom should therefore be used to allow flexibility in response to shocks or to provide for an increased level of capital investment. The operating balance rule is the primary fiscal rule adopted at Budget 2022 alongside the debt ceiling (The Treasury, 2022c).

The PFA requires appropriation limits to be set by every ministry and the FRA extended this to cover accrual budgeting at the whole-of-government-level. The purpose of these appropriations is to constrain and therefore no expenses or capital expenditure may be incurred unless in accordance with an appropriation or other statutory authority (The Treasury, 2019). These appropriation limits are set in nominal terms for four years ahead on an annual rolling basis. The limits are fully extended to all expenditure, revenue, assets and liabilities. Financial disclosure rules preclude any additional expenditure. The budget is prepared using the full suite of accrual accounting measures (Generally Accepted Accounting Principles) in its forecasts and budgetary decision-making as has been the case for going on three decades. The appropriation limits are fully integrated into the budget process and presented to the parliament as part of the budget package. Parliament has very limited powers to amend executive budget proposals.

New Zealand achieves its aim to be highly transparent through the Government publishing extensive budget information and budget guides to citizens and the parliament (OECD, 2019). Since 2006, it has included publication every four years of fiscal sustainability projections, taking account of underlying factors, such as ageing of the population. Buckle (2018) says 'this reporting created greater public awareness of the influence of forces likely to impact on New Zealand's future fiscal position'. More

¹⁸ At Budget 2022, the Government adopted a new net debt measure to bring New Zealand closer in line with international reporting of net debt and improve comparability of New Zealand's fiscal position with other countries. The new indicator includes Crown entity borrowings, core Crown advances, and all assets and liabilities of the NZ Super Fund (Page 60-64 on fiscal indicator review, Investment Statement 2022, <https://www.treasury.govt.nz/sites/default/files/2022-03/is22-hphp-v2.pdf>)

broadly, he claims that New Zealand's pioneering role had influenced the development of the IMF's Fiscal Transparency Code.

Though information may be more easily digestible than in most countries, monitoring of political commitment to the framework and fiscal rules still needs to be done. This is where possible criticism may arise as there is no external independent fiscal institution overseeing the Government. There is a constitutionally independent government body in the Auditor-General who audits all public entities, but its remit is limited to auditing the public finances. With macroeconomic forecasts also coming from inside the government (although the forecasts are published independently by the Treasury), there is essentially no external monitoring even though the Auditor-General is seen as an entirely independent body. In having no independent fiscal council, New Zealand is among a shrinking minority of advanced economies in this respect (IMF, 2022).

Political commitment to the framework is very strong, despite the lack of legal requirements and external monitoring. Indeed, Buckle (2018) argues that 'the framework allows governments to set broadly similar debt objectives but with differences in the make-up of government expenditure and taxes'. There are a few key reasons behind this:

1. with transparency of the framework being so high, the political cost of not following the targets is considerable;
2. each government has plenty of freedom to set its own targets because it is believed that this will increase the likelihood of them pursuing and succeeding in them; and
3. a transparency-based framework will usually be more flexible than a legislated fiscal rule, as exceptions based on economic factors can more readily be justified (The Treasury, 2015).

Net debt as a proportion of GDP has fallen dramatically from the early 1990s. It even survived the pandemic with it forecast to peak at 21.4% of GDP in 2023/24 in the Half-Year Update (published in December 2022). Though the reduction in debt is due to several factors, the fiscal responsibility provisions have certainly reinforced the multi-party commitment and understanding of the importance of fiscal sustainability that has played a key part in stabilizing public finances (The Treasury, 2015). The Treasury (2015) justified the absence of a hard legal approach by saying that legislated fiscal rules do not necessarily stand the test of time and do not easily adapt to ever-changing problems, and that they will usually not allow for enough flexibility to tackle these

problems. So far, their assessment has proved correct. Buckle (2018) concurs, especially in a key respect: ‘the principles and reporting provisions impinging on fiscal sustainability have probably been the most successful outcome of New Zealand’s fiscal responsibility framework’. However, he raises the question of the absence of an independent fiscal council.

During the pandemic, the economy saw an initial sharp contraction in the second quarter of 2020, but bounced back quickly in the second half of the year and had ‘one of the strongest recoveries in the OECD’ (OECD, 2022). Renewed occurrence of infections saw a further dip in GDP in the third quarter of 2021 and there are some concerns about the medium- and longer-term effects of the tough containment policies – greatly inhibiting external economic relations – on growth prospects.

There has been debate in New Zealand about whether, in particular, an IFI should be established, but the impression given by interviewees was that this is neither seen as a priority (despite IMF advocacy of such a move) nor were there obvious failings in the system to which an IFI would be the solution. One interviewee mentioned the well-known phrase “if it ain’t broke don’t fix it”. On the contrary, the framework appears to have weathered the storms of covid and geo-political tensions well enough.

Sweden

Sweden has long had a distinctive approach to economic governance, dating back to the “Rehn-Meidner” model developed in the early 1950s. This model tied together prudent macroeconomic policy, an objective of full employment, relatively compressed wage rates across occupations and active labour market policies. Although the full model was not always applied and did not endure as a framework beyond the 1980s, it has continued to exert some influence on the country’s economic philosophy.

However, after the major crisis of the early 1990s, when the general government deficit reached 15% of GDP, a new framework was progressively put in place, with greater resort to rules to underpin fiscal discipline. It shifted power from the legislature (the Riksdag) to the Finance Ministry, making it much harder for the former to vote for new spending commitments. A succinct description of the model is offered by Andersson and Jonung (2019):

“Although the framework has changed over time, the goals have remained the same: to keep public spending under control, and to ensure that the national debt ratio declines over time”

Today, Sweden’s budgetary and broader fiscal framework is characterised by:

1. A central government expenditure ceiling
2. The requirement for the local government sector to maintain balanced budgets;
3. A disciplined budget process.

In 2019, to complement 3), the government introduced a surplus target of $\frac{1}{3}$ of a percentage point of GDP on average over a business cycle and a debt anchor of 35% of GDP for government consolidated gross (Maastricht definition) debt. (OECD, 2019:243). A surplus target is not new in the Swedish framework, but it was lowered from the previous 1% of GDP target that had been in place for over 20 years. A cross-party surplus target committee (2016) which reviewed the target recommended it be lowered as net lending in the pension system increases demands on central government to save when the surplus target is unchanged. The targets are to be reviewed every eight years with the next revision set to take place in 2027, barring any unexpected events.

The Government has to report at least twice a year on whether the surplus target has been met. If it deems in its report that there has been a deviation from the target, it must explain to the parliament how a return to the target is to occur (Calmfors, 2020). It is unclear what is considered a deviation and what corrective measures need to be taken as, although there is a legal stipulation regarding this, its interpretation is left open. A deviation of more than five percentage points (in any direction) from the debt anchor target requires an explanation to the parliament too. Although not stated explicitly, Lars Calmfors (2020), a former president of the Swedish Fiscal Policy Council, believes that a deviation from the debt anchor in excess of five percentage points could trigger a reformulation of the surplus target.

In 1997, the Budget Act stipulated that the government shall propose an expenditure ceiling for three years ahead in the budget bill. Sweden was the first Nordic country to introduce such an expenditure rule (Calmfors, 2020). There is no formal regulation on which expenditures should be encompassed by the ceiling, but according to established practice, the ceiling covers nearly all cyclical expenditure, as well as central government contributions to the pension system. It excludes interest payments on na-

tional debt. The expenditure ceiling is set in nominal terms. The ceilings are not adjusted for inflation. Hitherto, this has not been a problem because inflation had been low during the entire lifespan of the framework up until Autumn 2021. It remains to be seen whether the current surge in inflation will require a rethink. For now, the Government decided to raise the ceilings for 2023-2025 in the 2023 budget bill.¹⁹

Local governments are not fully included in the central budget, although general grants to local government's within the central government expenditure ceilings make up about 20 percent of their revenue²⁰. Local governments are subject to balanced budget rules (OECD, 2019:243). In the case of an ex-post deficit rise, local governments are expected to cover it within a three-year period, but no sanction mechanism is in place if the requirements are not met (Calmfors, 2020). Central government has no legal ways of exercising control over local governments in economic distress. In procyclical fashion, local governments can accumulate rainy-day funds, but the size of these funds is small.

There is a presumption that active involvement of parliaments gives more weight to the plans set within the medium-term budgetary frameworks (MTBFs) and thus increases political commitment (Sherwood, 2015:22). In Sweden, such parliamentary adoption happens as a parliamentary vote is first required for the overall budget level and then another vote separately for the allocation of the budget between the different ministries. Although there are no formal obstacles preventing the Riksdag from reassessing and modifying established ceilings, they are still not expected to be changed, whatever the circumstances, unless a new government comes to power²¹, or a new and completely different external circumstance arises. Should an approved ceiling be deemed to be at risk of being exceeded, the Government is required to take measures during the current year to avoid it (Sherwood, 2015:29). The cost of mandating corrective action is only reputational and not formal, but the reputational costs are considerable.

Although the framework lacks a formal escape clause, the framework does allow for some flexibility with a buffer to be used for expenditure arising from unforeseen cyclical factors and inflation. The buffer is implemented in the form of a budgetary margin that amounts to 1% of the forecast expenditure for the year t , 1.5% for $t+1$, 2% for $t+2$

¹⁹ [Regeringens proposition 2022/23:1](#)

²⁰ The share of central government's general grants to local governments is expected to have amounted to 15.6% of total expenditure of regions and municipalities in 2022 (Statistics Sweden, 2023; The Government of Sweden, 2022).

²¹ The ceilings were lowered in 2006 when the liberal-conservative government took office and raised when a new government was formed by the Social Democrats and the Green Party in 2014 (Calmfors, 2020).

and 3% for $t+3$ (Sherwood, 2015:27). The expenditure ceilings are expressed in nominal terms to keep them simple and understandable, which is why large buffers are deemed necessary.

The Swedish expenditure ceiling has never, at least formally, been exceeded. However, in the spring of 2020, the Government, with the Riksdag's backing, proposed an increase in the level of the expenditure ceiling for 2020. This was followed by approved increases in the expenditure levels for 2021 and 2022 in the budget bill for 2021. An audit report by The Swedish National Audit Office in December 2020 described the raised level of the expenditure ceiling for 2020 to be in line with the Swedish framework. However, it described the increases in 2021 and 2022 to be incompatible with the framework and at risk of leading to less effective spending priorities (Riksrevisionen, 2020). They feared the raises would risk budgetary discipline.

By 2023, expenditure as a proportion of GDP is expected to be back to the share of GDP in 2019, before the pandemic. The inference to draw is that the expenditure ceiling has a restrictive effect on central government expenditure in the medium-term perspective by restricting the possibilities of permanent increases in expenditure between 2020 and 2023. By returning to the same ceiling level in relation to GDP as the one applied before the pandemic, the Government limits the scope of permanent spending increases during the period of the crisis. (Fiscal Policy Audit Network, 2022:26).

Although not a member of the Eurozone, as a member of the European Union (EU), Sweden is still expected to abide by the Stability and Growth Pact (SGP), although it would not face meaningful sanctions if it transgressed. It can, however, be put in the corrective arm of the SGP, obliging the government to act to conform to the SGP rules. Sweden has never been put into the corrective arm. In 2011, Sweden was among the 25 signatories of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (the Fiscal Compact), but the provisions of the Compact appear to have had little impact on Swedish fiscal policy.

Monitoring and evaluation of fiscal policy is carried out by four independent bodies. They are: the Fiscal Policy Council (Finanspolitiska rådet), the National Institute of Economic Research (Konjunkturinstitutet), the National Financial Management Authority (Ekonomistyrningsverket) and the National Audit Office (Riksrevisionen). The National Institute of Economic Research and the National Financial Management Authority are independent entities that assess macroeconomic and public sector financial developments, and present recommendations on fiscal policy. The National Audit Office is an authority under the Riksdag charged with auditing central government operations and producing performance audit reports. The Government must reply to these reports within four months of receiving them, describing corrective measures taken or intended to be taken by the Government.

The Fiscal Policy Council, which acts as a fiscal watchdog, is the most important for the fiscal framework. It adds transparency and clarity about the aims and effectiveness of economic and fiscal policy (Jonung, 2014a). It aims to achieve this by reviewing the government's success in achieving the fiscal and economic policy objectives the Riksdag has decided on by the government's proposition. These objectives include maintaining the long-term sustainability of public finances and a fiscal policy stance consistent with cyclical developments in the economy, as well as achieving the surplus target, and conforming to the debt anchor and the expenditure ceiling. The Fiscal Policy Council also assesses whether the fiscal policy is in line with long-term sustainable growth and long-term sustainable high employment. It does not undertake macroeconomic forecasting, but it does assess and scrutinize the Government's forecasts.

Established in 2007, the Fiscal Policy Council has been able to build up a reputation for competence and importance and its annual reports are widely covered in the media (Jonung, 2014b). Its members are mostly academics, but unlike other Nordic Fiscal Councils, practical experience is valued too. Like in Denmark and Finland, the remits of the council are broad and can go beyond just fiscal policy evaluation to include evaluation of other economic policies evaluation too.²² In fact, the Council can examine any topic it considers to be worthy of investigation, and regularly does.

The Finance Committee of the Riksdag uses its reports as an input for Committee's evaluation of the economic policies of the Government (Jonung, 2014b). Politically, the Government has no choice but to respond to the Council's reports in the budget bill in the Autumn, as the adverse reputational consequence for the government of neglecting the report would be considerable (Calmfors, 2020). The Riksdag then debates the bill's contents and later determines the budget in two stages: first the overall ceiling and then allocation of the funds in detail. This order of decision-making is a distinctive feature of the Swedish system, separating the aggregate decision on the fiscal stance from the detailed selection of spending priorities.

Overall, the Swedish framework seems to be among the strictest, but also the most effective, among the EU Member States (Sherwood, 2015:29). Its strictness does not, however, come from legal requirements as they are rather broadly defined. Rather, what matters is the strong political commitment to the framework, which is mostly achieved through established practices and the threat of reputational costs to the governing parties in power, not legally based restrictions and sanctions. This is demonstrated by the fact that the Swedish expenditure ceiling has never been exceeded

²² Other possible evaluation targets may be growth and employment issues, the clarity of the government's economic-policy documents and income distribution (Calmfors, 2020).

(The Fiscal Policy Audit Network, 2022:20). However, it is worth noting that ceilings can be raised mid-term to avoid exceeding it, as was done to combat the pandemic. Another key element behind the success of the Swedish framework is the successful anchoring of the medium-term targets of an expenditure ceiling and a surplus target to the long-term target of a stable low debt level.

With public debt and expenditure well controlled and with the economy growing, the Swedish fiscal framework can be adjudged to have been a success. Andersson and Jonung (2019) argue it may have even been too successful in that public debt may turn too low in the future. This may lead to political pressure to lower further, or even remove, the surplus target and give greater emphasis to the debt anchor. While the framework may need constant work, it is striking how it has managed to maintain its restrictive effect even in the periods of crisis of the last fifteen years.

The performance of the economy will have helped: compared with most other EU countries, Sweden has had impressive economic growth in the last decade, with positive effects on its public finances. What is less clear is how well the framework would cope with an extended period of inflation. However, a potential concern is that the setting of the expenditure ceiling in nominal terms, even with the sizeable buffer, may become harder to sustain if public sector pay increases in response to rising costs of living require additional spending.

Annex 2: List of interviewees

Denmark

Lars Haagen Pedersen, Deputy Permanent Secretary of Fiscal sustainability, tax policy, structural policy and climate models at the Ministry of Finance

Mads Kieler, Deputy Permanent Secretary of Economy and economic development at the Ministry of Finance

Martin Nygaard Jørgensen, Deputy Head of Department and Head of Macroeconomic Analysis at Danmarks Nationalbank

Per Callesen, member of the Board of Governors of Danmarks Nationalbank

Torben Andersen, Professor at the Department of Economics and Business Economics, Aarhus University and an active and former member and chair of several Nordic Economic Councils

European Commission

Lucio Pench, Director of Macroeconomic policies (ECFIN.C)

Jens Matthiessen, Economic Analyst – Fiscal desk officer for Finland (ECFIN.F.4)

Alejandro Paz Otero, Policy Analyst – Recovery and Resilience Facility (ECFIN.F.4)

Finland

Jonna Berghäll, Budget Counsellor at the Fiscal Policy Analysis Unit of the Ministry of Finance

Martti Hetemäki, Professor of Practice at the Helsinki Graduate School of Economics

Roope Uusitalo, Professor of Public Economics at the University of Helsinki and VATT

Sini Salmi, Senior Auditor (Monitoring and Oversight, Fiscal policy audit, Fiscal policy monitoring) at the National Audit Office of Finland

Vesa Vihriälä, Professor of Practice at the Helsinki Graduate School of Economics

IMF

Raphael Lam, Deputy Division Chief at the Fiscal Policy Division in the Fiscal Affairs Department

Andresa Lagerborg, Economist

Ireland

John FitzGerald, Adjunct Professor at the Department of Economics, Trinity College Dublin

Eddie Casey, Chief Economist and Head of Secretariat at the Irish Fiscal Advisory Council

Matthew McGann, Principal Officer Economist at Department of Finance

The Netherlands

Frist Bos, Senior Researcher at the CPB Netherlands Bureau for Economic Policy Analysis

Joost Clerx, Director of Budgetary Affairs at the Ministry of Finance

Krista Bruns, Senior Policy and Budget Advisor at the Ministry of Finance

Richard van Zwol, Member of the Advisory Division of the Council of State and Chair of the EU Network of Independent Fiscal Institutions

Roel Beetsma, Dean of the Faculty of Economics and Business of the University of Amsterdam and Professor of Macroeconomics, and a Member of the European Fiscal Board

Suzanne Meijer, Economist at the Advisory Division of the Council of State

New Zealand

Bob Buckle, Professor Emeritus at Victoria University of Wellington

John Janssen, Principal Advisor at the Treasury

Shefalika, Senior Analyst at the Treasury

Sweden

Lars Heikensten, Chairman of the Swedish Fiscal Policy Council

Lars Jonung, Professor Emeritus at the Knut Wicksell Centre for Financial Studies, Department of Economics, Lund University, and former chairman of the Swedish Fiscal Policy Council (2012-13)

Phillip Löf, Senior Economic Advisor at the International and Economic Department of the Ministry of Finance

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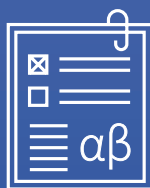
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