

Auditing the computation of structural balance

Finland has set a medium-term objective for the structural balance of its public sector. This objective is currently -0.5 per cent of GDP. Legislatively, the setting of the objective is related to the reform of multilateral surveillance and coordination of fiscal policy in the EU. The legal framework for the setting of the medium-term objective in Finland is laid down in the act on the implementation of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (EMU), the implementation of Treaty provisions of a legislative nature as well as requirements concerning multi-annual budgetary frameworks (869/2012) that entered into force at the beginning of 2013. Normally, a significant deviation from the objective may lead to the launching of a correction mechanism, in which case corrective action must be taken so that the medium-term objective set for the public sector can be met. As the medium-term objective is determined in terms of a structural balance, the structural balance influences fiscal policy through the medium-term objective and the correction mechanism. The calculation of the structural balance is a technical process. As the process is not particularly transparent, there are good reasons for verifying it.

The National Audit Office's audit of the computation of structural balance has two goals. Firstly, it sets out to verify that the computation produced by the Ministry of Finance is correct. Secondly, the aim is to make the computation of structural balance more transparent.

The National Audit Office independently repeated the computation of structural balance carried out by the Ministry of Finance in spring 2013, carefully examining the Ministry's computation and the assumptions on which it was based. In order to assess the Ministry's computation on other than purely mathematical basis, the National Audit Office compared the computation with the comparable computation of structural balance produced by the European Commission.

The verification performed by the National Audit Office revealed no major errors in the computation of structural balance produced by the Ministry of Finance in spring 2013. Based on the audit, the Office states that the computation made by the Ministry of Finance in spring 2013 was mostly correct. However, the National Audit Office draws attention to the fact that the potential output forecast produced by the Ministry of Finance in spring 2013, which corresponds to the Ministry's medium-term GDP forecast of the time, exceeds the Commission's forecast. The forecast is partly based on expectations that are unlikely to become reality. In particular, the faster accumulation of capital in the Ministry's figures compared with the Commission's forecast is founded on an assumption for which it is difficult to find any economic basis. In the National Audit Office's view, the Ministry's forecast is not entirely unrealistic but it would like to see better economic grounds for the forecast. In general, the assumptions underpinning the estimates of potential output should be more thoroughly justified in the Ministry's reports.

Finally, the National Audit Office expresses concern over the growth of total factor productivity in Finland, which has almost come to a halt after the financial crisis. The trend in total factor productivity is a key factor determining potential output and the growth of GDP in the longer term. One can also say that the trend in total factor productivity determines the growth of Finland's prosperity over the long term. Forecasting total factor productivity growth is difficult, and it is likely that this trend will improve somewhat as the financial crisis and debt crisis recede. However, as total factor productivity plays a key role in determining our economic well-being, a close eye should be kept on its fluctuations.