Fiscal policy monitoring assessment on management of general government finances

This memorandum contains the main points of the National Audit Office's preliminary assessment of the status of government finances in 2019 and 2020. The assessment takes into account the Government's draft budgetary plan and budget proposal for 2020 and the General Government Fiscal Plan for 2020–2023. The assessment is based on an independent economic forecast produced by the Ministry of Finance and other economic forecasts. The National Audit Office presented its previous assessment in the fiscal policy monitoring assessment published on 23 May 2019. The National Audit Office will publish a more extensive report on fiscal policy monitoring as a separate report to Parliament in December 2019. The economic policy objectives set for the parliamentary term, the sustainability of general government finances and the tax policy, for example, will be dealt with in greater detail in the report than in this memorandum.

It is a statutory task of the National Audit Office, as part of the auditing of central government finances, to supervise compliance with the Fiscal Policy Act (869/2012) and the provisions issued thereunder, such as the Government Decree on the General Government Fiscal Plan (120/2014). To carry out its supervisory task, the National Audit Office has, under the above regulations, assessed the draft budgetary plan and the materials on which it is based, including the Government's budget proposal for 2020 and the economic forecast by the Ministry of Finance on which it is based.

The Government's budget proposal for 2020 and the General Government Fiscal Plan for 2020–2023 were submitted to Parliament on 7 October 2019. Finland's draft budgetary plan for 2020 was published in the same connection. The European Commission will provide its view on the draft budgetary plan in compliance with the regulation on common provisions for monitoring and assessing draft budgetary plans in November 2019.

Summary of the assessment

The economic policy objectives set for the new parliamentary term are extensive. They include a target related to balanced general government finances, a target related to improving the employment rate, a target related to decreasing inequality and narrowing the income gaps, and a target related to achieving carbon neutrality. When the Government Programme was prepared, the balance target did not seem particularly tough, but the weakening of the economic situation at the beginning of the parliamentary term and the outlook for the next few years have made it challenging. The balance target of the Government Programme is valid under normal global economic circumstances. Although this condition leaves room for interpretation, it is justified from the perspective of transparency and the appropriate stance of fiscal policy.

The General Government Fiscal Plan corresponds in material respects to the statutory requirements. The targets have been set according to the obligations, but, based on current forecasts, they will not be achieved without additional measures. In this General Government Fiscal Plan, the Government has not yet proposed detailed measures for turning the trend so that the targets could be achieved.

According to the current estimate, there is a risk that Finland fails to comply with the preventive arm of the EU Stability and Growth Pact in 2020. This is influenced, for example, by the launch of a one-off future-oriented investment programme in 2020 and the fact that the permanent increases in expenditure during the parliamentary term are front-loaded as compared with the increases in tax revenue, which will improve the general government structural balance. A significant deviation from the Pact may thus arise in the structural balance of general government bodies. However, in light of the information presently available, the limit would be exceeded by only a small degree. According to the preliminary assessment, the expenditure of general government will also grow faster than allowed in 2020. Despite the uncertainty involved in the assessments, the National Audit Office encourages the Government to pay attention to the risk of a significant deviation from the obligations set by the preventive arm of the Stability and Growth Pact. In the spring of 2021, the National Audit Office will make a final assessment on Finland's compliance with the Pact in 2020.

The Government Programme takes the long-term sustainability of general government finances into account by aiming at the improvement of the employment rate and the productivity of public service provision. Achieving these goals would improve the sustainability of general government finances. A key method for enhancing the sustainability is the development of the social and health care system, taking into account both the needs of general government finances and the need for available high-quality care. The Government Programme provides good starting points for preparing the reform of the social and health care system. Transferring the responsibility for service provision to areas with a larger population is necessary in order for the service provision to be both economical and effective in the future.

The Government aims at 60,000 new employed persons. Based on the employment potential, it is possible to achieve this target, provided that measures are prepared and implemented resolutely. Considering the differences between the employment potential of different population groups, the best way to proceed towards the employment rate target without excessive costs would probably be targeted reforms. A comparison between the Nordic countries shows that the biggest employment potential resides in the older age groups.

At present, it seems that the fiscal policy at the beginning of the parliamentary term is neither clearly pro-cyclical nor clearly counter-cyclical. Appropriate reviews are planned under the Government Programme and the General Government Fiscal Plan during the parliamentary term on the implementation of the measures for improving the employment rate, the permanent increases in expenditure, and the latter part of the one-off investment programme. The so-called mechanism for exceptional circumstances, which has been included in the spending limits rule of central government, is also justified. When spending limits are determined for a period of four years, it is not possible to anticipate a severe recession that might occur during the period and that might justify an increase in expenditure to smooth the business cycle.

The GDP (gross domestic product) forecast of the Ministry of Finance for 2019 is among the highest forecasts, whereas the GDP growth forecasts of the Ministry for 2020 and 2021 are lower than the median forecast and the average. On the basis of the review, the economic forecast of the Ministry of Finance on which the General Government Fiscal Plan is based cannot be considered unrealistic as a whole in the sense referred to in the legislation.

The economic policy objectives set for the parliamentary term are mainly consistent

The economic policy objectives set for the parliamentary term are extensive. They include a target related to balanced general government finances, a target related to improving the employment rate, a target related to decreasing inequality and narrowing the income gaps, and a target related to achieving carbon neutrality. The balance target is closely connected with the employment rate target as regards both the time frame and the impacts, although the different methods for improving the employment rate target may have different kinds of impacts on the balance of general government finances. The connection of inequality, income gaps and carbon neutrality with general government finances is more complicated, and the target related to carbon neutrality has, moreover, a different time span than the other targets.

According to the balance target set for general government finances in the Government Programme and the first General Government Fiscal Plan of the parliamentary term, revenue and expenditure should be in balance in 2023. The target set is tough. According to the forecast of the Ministry of Finance, which is included in the General Government Fiscal Plan and which takes into account the measures already decided by the Government, general government finances are expected to show a deficit of 1.4 per cent relative to GDP in 2023. However, when the Government Programme was drafted, the target did not seem particularly tough considering the forecasts at the time. Based on the trend projection by the Ministry of Finance, a deficit of 0.6 per cent was then projected for 2023. This was a considerably lower deficit than, for example, the deficit that was forecast in the autumn of 2015 for the end of the then-ongoing parliamentary term.

The target related to balanced general government finances is subject to a condition according to which the target is valid under normal global economic circumstances. The wording of this condition leaves some room for interpretation. Generally speaking, it is still justified. Should the global economic circumstances during the parliamentary term prove to be very weak, keeping the balance target valid might lead to unjustified pro-cyclical fiscal policy. In view of the transparency of the target setting, it is also good that the reservation related to the target has been presented in advance, so that it will not be necessary to adjust the target in the middle of the parliamentary term.

It is good that the Government Programme does not set any targets related to the amount of government debt or the tax rate. For debt sustainability, the development of the amount of government debt is secondary to the development of debt and net debt (considering also government assets where appropriate) relative to GDP. A tax rate target, in turn, would unnecessarily restrict the fiscal policy methods available during the parliamentary term.

The General Government Fiscal Plan corresponds in material respects to the statutory requirements

The Medium-Term Objective (MTO) set by the General Government Fiscal Plan for general government structural balance relative to GDP, as referred to in Section 2 of the Fiscal Policy Act (869/2012), is –0.5 per cent. The objective complies with the minimum level of the Fiscal Compact. The General Government Fiscal Plan sets multi-annual objectives for the ratio between the fiscal position of general government and GDP and, in addition, separate targets for the different sub-sectors of general government finances. These targets have been set in such a manner that the objective set for the structural fiscal position of general government will at least be achieved.

However, in light of the forecast by the Ministry of Finance, these targets will not be achieved (see Figure 1). According to the forecast by the Ministry of Finance, the general government structural balance will be –1.4% relative to GDP in 2023. This is 0.9 percentage points higher than the MTO set for the structural balance by the Government, which is also the minimum level set by the Fiscal Compact. The nominal fiscal position target set by the Government for 2023 is 0.0% of GDP. The forecast by the Ministry of Finance for the fiscal position in 2023 is –1.4% of GDP.

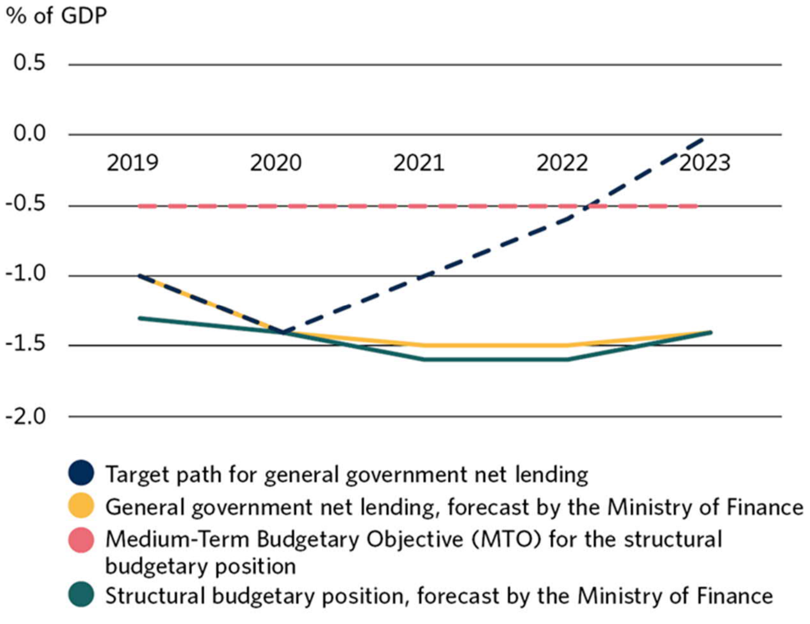

Figure 1: The fiscal position targets set by the Government and the forecasts by the Ministry of Finance. Source: the Ministry of Finance, the General Government Fiscal Plan

According to Section 3 of the Decree on the General Government Fiscal Plan (120/2014), the General Government Fiscal Plan shall include assessments of the key revenue and expenditure in general government and its sub-sectors both without legislative amendments and with the legislative amendments specified by the Government. The impact of both of these options on the medium-term structural fiscal position and long-term sustainability of general government finances should be presented under the Decree. In addition, the General Government Fiscal Plan should specify the measures required for achieving the fiscal position targets and their estimated financial impact. The General Government Fiscal Plan has not yet specified these measures. This is partly explained by the fact that the parliamentary term has only just begun.

According to the forecast by the Ministry of Finance, the deficit of local government in 2023 will be EUR 3.1 billion, i.e. –1.2 per cent of total production. According to Section 3 of the Decree on the General Government Fiscal Plan (120/2014), a cap in euros shall be set for changes in local government expenditure caused by central government measures. This cap shall be in line with the target set for the fiscal position of local government. According to the target set for the fiscal position of local government, the deficit should be no more than 0.5 percentage points of GDP in 2023. In its General Government Fiscal Plan, the Government has laid down that the net impact of its measures in 2023 will not increase the operating expenses of local government by more than EUR 520 million. However, the measures included in this expenditure limit are estimated to have an almost neutral combined impact on local government finances, as the related government transfers and grants will grow almost accordingly. Thus, the total level of the expenditure limit will not bring local government closer to its fiscal position target, nor will it complicate the achievement of the target.

There is a risk of a significant deviation from the preventive arm of the Stability and Growth Pact in 2020

The preventive arm of the EU's Stability and Growth Pact assesses compliance of general government finances with the Medium-Term Objective (MTO) or progress towards it. The assessment is based on changes in the structural balance and the expenditure benchmark. Finland is in the preventive arm of the Pact and, thus, shall comply with the obligations set by the preventive arm. The National Audit Office assesses Finland's compliance with the Pact in 2019–2020 preliminarily. The final assessments will be made in the spring following the year under review.

Structural balance describes the ratio between the fiscal position and GDP, less of the impact of economic cycles and one-off measures. The MTO set by Prime Minister Rinne's Government is to achieve a structural balance of at least –0.5 per cent. The target complies with the Fiscal Compact and the Stability and Growth Pact. The expenditure benchmark, in turn, sets a maximum rate for the increase in general government expenditure.

Finland has benefited from the flexibility offered by the Pact: under the structural reform clause, Finland was granted relief of 0.5 percentage points relative to GDP from the requirements for 2017–2019. In this assessment, the flexibility affects Finland's compliance with both the structural balance rule and the expenditure benchmark in 2019.

According to the current estimate, the structural balance will be down from –1.0 per cent of GDP in 2018 to –1.3 per cent in 2019 and further to –1.4 per cent in 2020. As a result of the flexibility, the deterioration of the structural balance would cause only a minor deviation from the rule in 2019, whereas a significant deviation from the rule might be expected in 2020 (see Appended Table 1). In light of the information currently available, the limit would be exceeded by only a small degree, and the figures still involve plenty of uncertainty. The National Audit Office assesses that there is also a risk of a significant deviation from the expenditure benchmark. According to the preliminary assessment, based on the expenditure benchmark, general government expenditure will thus grow faster than allowed next year (see Appended Table 2). The cumulative deviation, i.e. the deviation based on two-year average, would also exceed the limit for a significant deviation both in 2019 and in 2020. According to the preliminary assessment, the deviation from the expenditure benchmark in 2019 will not exceed the limit for a significant deviation.

In view of the above, there is a risk that Finland fails to comply with the preventive arm of the EU Stability and Growth Pact in 2020. This is influenced by the launch of a one-off future-oriented investment programme in 2020 and the fact that the permanent increases in expenditure during the parliamentary term are front-loaded as compared with the increase in tax revenue, which will improve the structural balance. Although there is uncertainty involved in the assessments, the National Audit Office encourages the Government to pay attention to the risk of a significant deviation from the obligations set by the preventive arm of the Stability and Growth Pact. In the spring of 2021, the National Audit Office will make a final assessment on Finland's compliance with the Pact in 2020.

The aim of the corrective arm of the Stability and Growth Pact is to ensure compliance with the deficit and debt criteria specified in the EU Treaty. According to the debt criterion, central government gross debt may not exceed 60 per cent of GDP. Correspondingly, according to the deficit criterion, the nominal deficit of general government bodies shall not exceed 3 per cent of GDP.

According to Statistics Finland (21 October 2019), the general government debt ratio was 59 per cent of GDP in 2018, and the Ministry of Finance forecasts in its Economic Survey of autumn 2019 that the debt ratio will remain at around 59 per cent in 2019–2020. The debt ratio is expected to be lower than the 60 per cent reference value in the years under review. According to the preliminary assessment, Finland would thus comply with the debt criterion during the years under review. According to the forecast by the Ministry of Finance, the debt ratio will start to grow in 2021, which may risk compliance with the rules in the future.

According to Statistics Finland (21 October 2019), the general government deficit was 0.8 per cent of GDP in 2018, and the Ministry of Finance forecasts that the deficit will grow to –1.4 per cent of GDP by 2020. During the period under review, the deficit will thus be clearly below the reference value of 3 per cent. However, still in spring 2019, the Ministry of Finance forecast that the deficit would achieve balance in 2020.

The productivity of public services must be improved to ensure the sustainability of general government finances

The Government Programme takes the long-term sustainability of general government finances into account by aiming at the improvement of the employment rate and the productivity of public service provision. Achieving these goals would improve the sustainability of general government finances. In addition to the improvement of the employment rate, a key method for enhancing the sustainability is the development of the social and health care system, taking into account both the needs of general government finances and the need for available high-quality of treatment. The current level of social and health care expenditure in Finland corresponds to the EU average, but the ageing population puts an upward pressure on it. Based on the reviews of the Working Group on Ageing Populations and Sustainability (AWG) of the EU Member States and the EU Commission, the upward pressure concerns mainly long-term care, such as care for the elderly, and to a clearly lesser extent, the actual health care expenditure.

The Government Programme provides good starting points for the preparation of the reform of the social and health care system. Transferring the responsibility for service provision to areas with a larger population is necessary in order for the service provision to be both economical and effective in the future. Although cost benefits will not be automatic, larger service provision units will nevertheless make it easier to achieve economic benefits for instance through economies of scale in production, bargaining power related to purchases, and faster changes to improve productivity (e.g. changes related to digitalisation or management systems).

It is possible to achieve the employment rate target if measures are targeted successfully

The new Government aims at improving the employment rate to 75 per cent (by 60,000 employed people) by 2023 with its employment measures. So far only a few concrete details about the employment measures, whose employment impacts could be estimated, have been disclosed. The measures set out in the Government Programme may also have an adverse effect on the employment rate. The Government Programme outlines abandonment of the activation model. According to the report (VATT Tutkimukset 189) ordered by the Ministry of Economic Affairs and Employment, the model may have increased the probability of termination of unemployment among those who receive earnings-related unemployment benefit. It is, however, difficult to assess the impacts of the active model.

The preparation of the employment measures should observe the differences between the employment potential of different population groups and the factors underlying these differences. A comparison between the employment rate in Finland and the average of the Nordic countries reveals three groups with the highest employment potential: older people, women of child-bearing age, and young people. However, it should be noted that the employment rate of young people in Denmark differs considerably from that of the other Nordic countries. If Denmark were excluded from the comparison (leaving only Norway and Sweden), only young women and older people would stand out in Finland because of their employment potential.

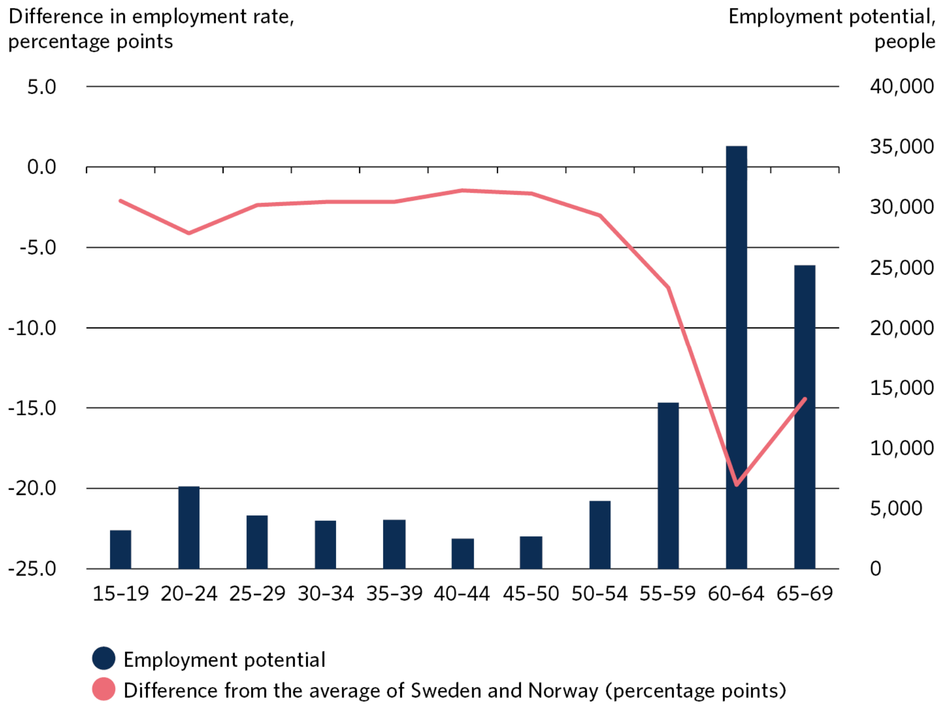

Figure 2: The difference of the employment rate in Finland from the average of Sweden and Norway, and the employment potential – men by age group. Source: the NAOF's calculations based on the information provided by Eurostat and Statistics Finland

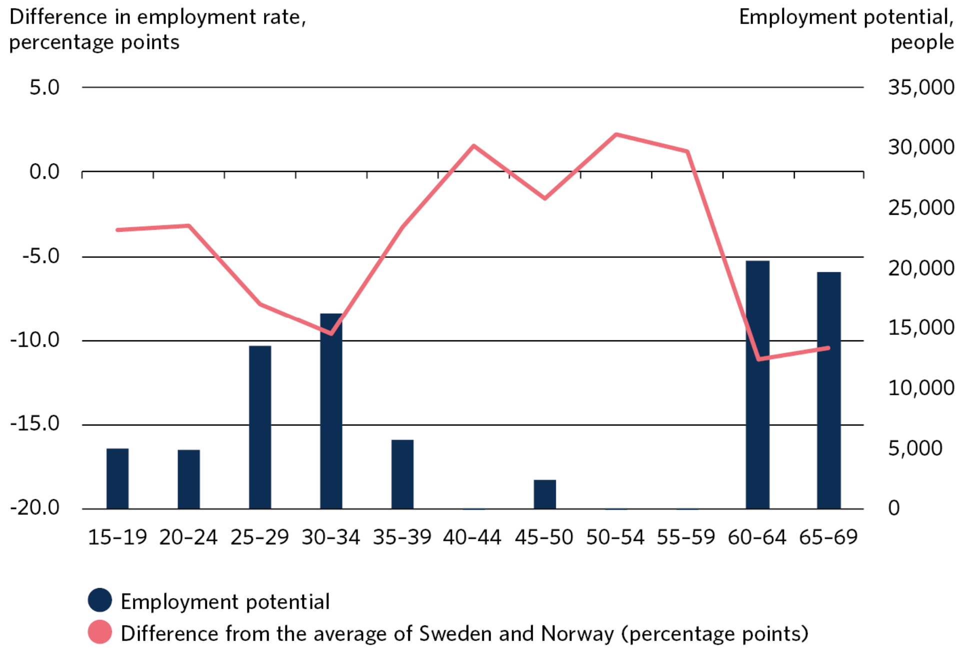

Figure 3: The difference of the employment rate in Finland from the average of Sweden and Norway, and the employment potential – women by age group. Source: the NAOF's calculations based on the information provided by Eurostat and Statistics Finland

A direct comparison with Sweden yields qualitatively similar results. However, if it is considered how common part-time work is particularly in Sweden, the potential of young women becomes somewhat questionable in view of the employment rate, as part-time work is not very common in Finland. The comparison is further complicated by the fact that, in Sweden, statistics show people on family leave as employed, whereas in Finland they are considered non-employed (see Kambur & Pärnänen 2017). For this reason, a comparison between employment rates only does not give a clear picture of the differences between the countries, particularly in the case of women with small children. The fact that Finland and Sweden have different family leave systems makes the problem even more challenging.

If the work attendance rates are compared instead of the employment rates, there is no significant difference between women in Finland and Sweden. Nevertheless, there is still a considerable difference between mothers of children under three years. If the work attendance rate is used as an employment indicator, the difference between women in Finland and Sweden is narrowed from six to about two percentage points.

The working age profile shows clearly that the most significant potential for improving the employment rate resides among older people – particularly among older men. Employment potential of more than 60,000 people (which corresponds to the Government's target) can be found among men of 55 to 69 years alone. As regards women, the greatest potential is found among those of 60 to 69 years (40,000 people).

More generally speaking, it can be stated that the employment rate of Finnish men, in particular, is not higher than in the other Nordic countries in any age group. Reforms not targeted at any specific age group can therefore be considered justified. However, in view of the differences in the employment potential of different age and gender groups, targeted reforms would still be the most probable way of achieving the employment rate target without excessive costs. In the case of older people, in particular, it might be useful to review the entirety of the incentive and support system, training and job-search assistance, and active labour market policies applicable to them.

The fiscal stance at the beginning of the parliamentary term is neither clearly pro-cyclical nor clearly counter-cyclical

The Government Programme and the General Government Fiscal Plan increase the permanent general government expenditure by about EUR 1.4 billion. It is stated in the General Government Fiscal Plan that most of the additional expenditure will become effective in 2020. Discretionary increases in expenditure will be funded mainly by increasing tax revenue. The Government Programme includes a one-off investment programme of EUR 3 billion in total for 2020–2023. The General Government Fiscal Plan included decisions on the use of EUR 1.4 billion in 2020–2022.

According to the General Government Fiscal Plan, the permanent increases in expenditure during the parliamentary term are front-loaded as compared with the increases in tax revenue following the changes in tax criteria. One of the tax criteria changes was the removal of tax subsidy for paraffinic diesel, which complies with the cutbacks in business subsidies laid down in the Government Programme. In the future, it would be important to strive to prioritise business subsidies based on their effectiveness and to abandon subsidies that have been found to be ineffective.

It is justified to review the expenditure decisions when the budget for 2021 is prepared, as stated in the Government Programme, if impact assessments show that the Government decisions have not succeeded in improving the employment rate according to the milestone set. It is also appropriate for the General Government Fiscal Plan to link the decisions on the implementation of the latter part (EUR 1.7 billion) of the one-off investment programme with the review of the increase in expenditure and the measures for improving the employment rate.

However, because there is a need for counter-cyclical fiscal policy, the review involves a risk related to cyclical conditions. This might lead to a problem if the cyclical conditions were very weak at the time of the review and, at the same time, the decisions taken were found not to promote the employment rate target. In this case, any fiscal adjustment might be pro-cyclical and thus cause the economic trend to weaken further.

The fiscal policy stance can be assessed in relation to cyclical conditions in several alternative manners, all of which involve uncertainty. It is, for example, difficult to forecast what the cyclical conditions will be the next year – and even during the current year. Based on the indicators used by the National Audit Office (see Figure 4), the fiscal policy will be to some extent expansionary in 2020. The indicators show mild pro-cyclicality. Based on the available assessments, the fiscal policy will be close to neutral in 2021. The assessments of the cyclical conditions may still change, which may later change the conclusions made of the fiscal policy framework in relation to the cyclical conditions.

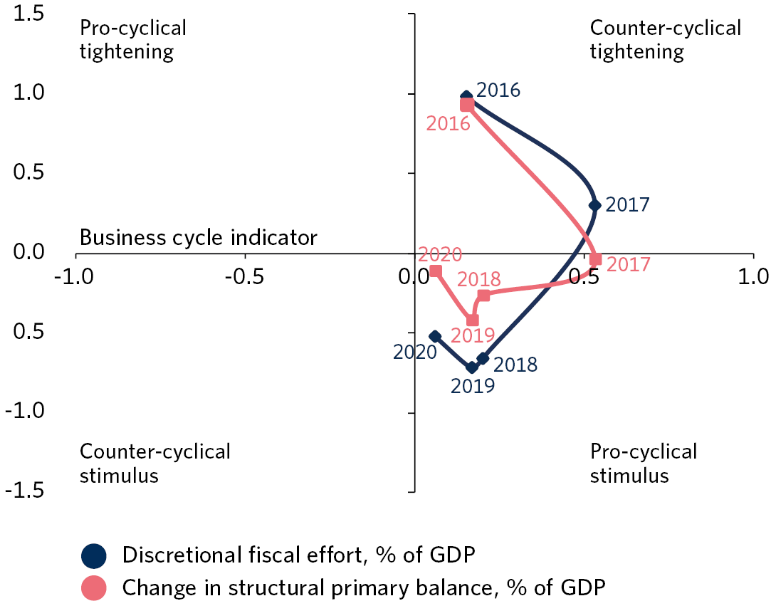

Figure 4: Fiscal policy stance in 2016–2020: indicator for discretionary measures and change in cyclically adjusted primary balance, % of GDP Source: The Ministry of Finance, calculations by the NAOF

The new mechanism to be used in severe economic downturn, incorporated into the spending limits system, does not jeopardise the credibility of the system

The spending limits rule of Rinne's Government conforms largely to those of the previous Governments. The biggest change is the incorporation of the so-called mechanism for exceptional circumstances into the rule. In addition, a statement that tax subsidies shall not be used to avoid the spending limits was returned to the rule. In connection with the Government's one-off future-oriented investment programme, it is stated that, if the EUR 1.7 billion provision made for the latter part of the programme is not used, the level of the spending limits will be lowered accordingly. This kind of a conditional entry, according to which the spending limits will be lowered accordingly if certain expenditure within the limits is not realised, has also been made in connection with fighter aircraft purchases and the energy tax refund system. In view of the nature of the expenditure in question, it is justified to use this kind of a conditional entry to lower the spending limits, if necessary. It also provides the spending limits with the flexibility needed if the expenditure is not necessary after all.

The National Audit Office has commented on the previous Governments' spending limits rules in its fiscal policy monitoring reports. Some of these comments are still relevant. It would have been important, for example, to define financial investments in greater detail in the spending limits rule. As regards compliance with the principles of the spending limits rule, it is essential that the financial investments falling outside the spending limits maintain their value. To increase transparency, it would be important to define the use and possible life cycle of financial investments clearly and to ensure that financial investments are not used for operating expenses, subsidies or similar expenditure. It would also have been important to clarify the processing of donated shares from the perspective of the spending limits rule. The report Kehysjärjestelmän kehittäminen vaalikaudelle 2019–2023 (Development of the spending limits system for the parliamentary term 2019–2023), published by the Ministry of Finance earlier this year, includes well-grounded proposals for clarifying these issues.

The mechanism for exceptional circumstances aims at providing flexibility to the spending limits in the event of a severe economic downturn. The existence of such a mechanism is justified: when spending limits are determined for a period of four years, it is not always possible to anticipate a severe recession that might occur during the period and that might justify an increase in expenditure to smooth the business cycle, notwithstanding the spending limits. The criteria for the activation of the mechanism have been specified in the Government Programme. The increase in expenditure enabled by the mechanism is also clearly defined. Both of these are important features for a credible mechanism.

The mechanism for exceptional circumstances cannot be assessed comprehensively until it has been used for the first time, as the criteria for its activation leave room for interpretation. However, it is possible to comment the usability and the criteria set for the activation of the mechanism on the basis of the Government Programme. The activation of the mechanism is partly dependent on indicators that determine the severity of a recession and that are assessed on the basis of independently provided information and partly on the complete picture of economy. This ensures that cyclical conditions are assessed in a balanced manner. However, in practice, it may be difficult to react to a recession in a timely manner: it takes time, for example, before the data describing the GDP trend becomes available and the decisions required to activate the mechanism are taken, and, in any case, unemployment reacts to a recession with a delay.

If the numerical indicators linked to the mechanism are examined to find out when the mechanism could have been activated previously in history, the data on actual GDP shows that the mechanism could have been activated, for example, at the end of 2008 or at the beginning of 2009 and in 1990–1991. In both of these periods, there was an exceptional recession. Thus, it seems that the mechanism does not involve a major risk that the indicators might react too easily to economic cycles and that the mechanism might be activated on too vague grounds. A bigger risk might be rather that the mechanism will not be activated quickly enough and in a timely manner. Because the threshold for activating the mechanism is high, it seems more likely that stimulus measures might be launched too late. On the other hand, reacting very fast – before the economic outlook is clarified – would weaken the credibility of the mechanism.

The Ministry of Finance forecast on which the General Government Fiscal Plan is based is not unrealistic

Under the Fiscal Policy Act (869/2012) and the Budgetary Frameworks Directive (2011/85/EU), the Member States must ensure that the planning of general government finances is based on realistic macroeconomic and fiscal forecasts. Under the Government Decree on the General Government Fiscal Plan (120/2014; as amended by Government Decree 601/2017), when preparing economic forecasts, the Ministry of Finance shall also take into consideration the conclusions of the National Audit Office on the macroeconomic and fiscal forecasts.

The budget proposal and the General Government Fiscal Plan are based on the macroeconomic forecast and the assessment of medium-term and long-term economic growth produced by the Ministry of Finance. The Ministry of Finance projects GDP growth of 1.5 per cent for 2019, 1.0 per cent for 2020, and 0.9 per cent for 2021. The preparation of the spending limits last spring was based on estimated economic growth of 1.7, 1.4 and 1.2 per cent for the above years, respectively.

This autumn's forecast for 2019 is higher than the median forecast (1.3) or average (1.4) of the forecasters followed and among the highest forecasts. Of the forecasters followed, seven projected growth of at least 1.5 per cent for 2019, whereas thirteen projected growth of no more than 1.4 per cent. Taking into account the dates on which the latest forecasts of all forecasters were published, it also appears that the forecasts are becoming more downbeat over time.

Figure 5 shows the Finnish forecasters' latest GDP forecasts for 2019 in relation to the date of issue. The middle line shows the linear trend of the forecasts (excl. the forecast by the Ministry of Finance), while the upper and lower lines illustrate the t-distributed 95% prediction interval. The figure illustrates the development of forecasts over time: more information and data updates from the National Accounts by Statistics Finland have been available for forecasts issued later. The forecasts issued closer to the end of the period are thus likely to be more accurate than those issued at the beginning of the period. In view of this, the GDP forecast issued by the Ministry of Finance for 2019 can be considered optimistic, as it is approximately at the same level as the upper limit of the 95% prediction interval at the time it was issued.

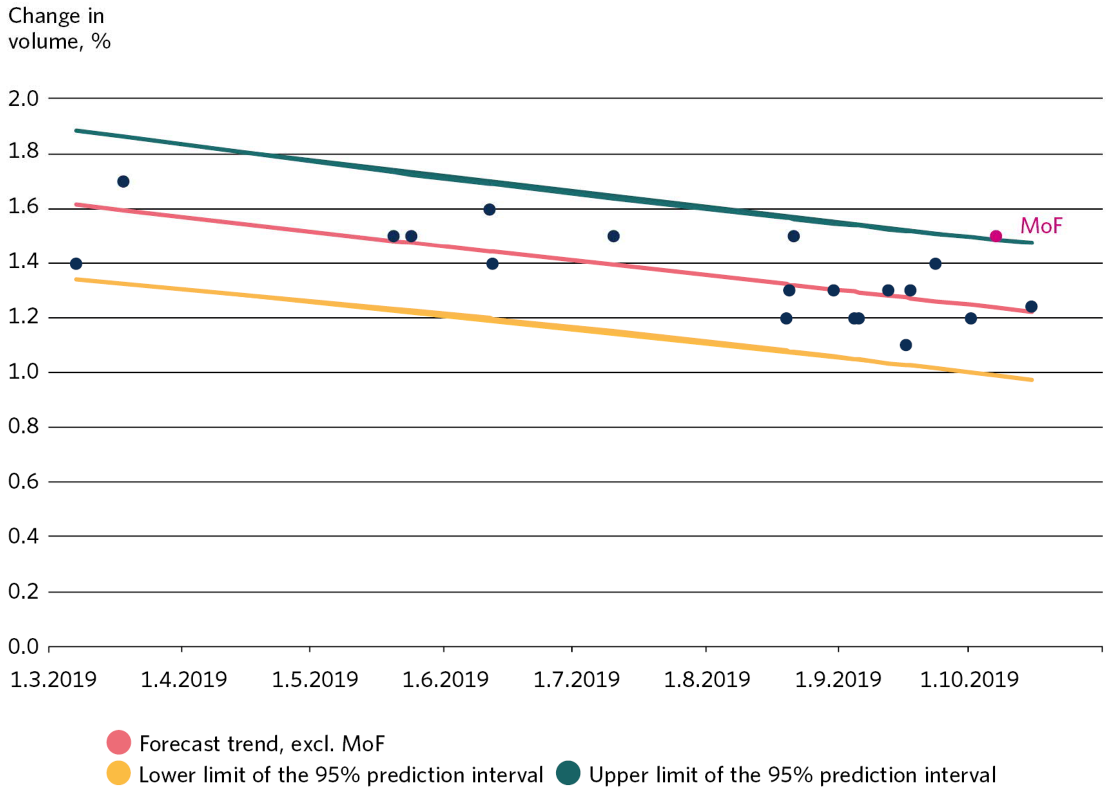

Figure 5: GDP forecasts for 2019. Source: different forecasters, NAOF

The GDP growth forecasts of the Ministry of Finance for 2020 and 2021, in turn, are lower than the median forecast and the average and somewhat more conservative than the linear trend. They also fall within the 95% prediction interval of the linear trend based on the sample of forecasts. On the same basis, the other key figures in the forecast of the Ministry of Finance also fall within the prediction intervals with the exception of the forecasts for the employment rate and the consumer price index in 2021 and the forecasts for private consumption in 2019 and 2020.

The employment rate forecast of the Ministry of Finance is more optimistic for all years than the linear trend of the other forecasts; however, it falls between the minimum and maximum of the other forecasts and within the prediction interval only in 2019 and 2020. The forecast of the Ministry of Finance falls outside the prediction interval and is higher than the maximum of the other forecasts only in 2021. However, it should be noted that the sample of forecasts is very limited, as there are only three forecasters for 2021 in addition to the Ministry of Finance, and the prediction interval is quite narrow, as the forecasts are very close to each other. The forecasts of the Ministry of Finance can be considered to be consistent with each other: as a result of the optimistic employment rate forecast, the Ministry's forecast for private consumption is also higher than the calculated linear trend (and higher than the maximum of the other forecasts in 2021), and, in addition to the growth of export, it also seems to drive GDP growth. However, this proves that the relatively optimistic economic outlook of the Ministry of Finance is based on continuous improvement of the employment rate.

	GDP	Imports	Private consumption	Public consumption	Exports	Investments	Unemplo-yment	Employment rate	Inflation	Current account	General government fiscal balance	General government gross debt
2018	1	2	1	2	2	2	2	2	2	2	1	2
2019	2	2	1	2	2	2	2	2	2	2	2	2
2020	2	2	1	2	2	1	2	0	0	1	1	2

2 The MoF forecast falls within the 95% prediction interval and the minimum-maximum interval

1 The MoF forecast falls outside the 95% prediction interval or the minimum-maximum interval

0 The MoF forecast falls outside the 95% prediction interval and the minimum-maximum interval

Figure 6: Forecasts of the Ministry of Finance in relation to the minimum–maximum intervals based on the other forecasts and the 95% prediction interval. Source: NAOF

Figure 6 shows whether the Ministry of Finance (MoF) forecasts fall outside the minimum–maximum interval of the other forecasts and/or the 95% prediction interval of the linear trend. On the basis of the review, the forecast of the Ministry of Finance on which the General Government Fiscal Plan is based cannot be considered unrealistic as referred to in legislation.

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Appended Table 1: General government structural balance, adjustment requirement (allowed deviation), and deviation. The NAOF's calculations (based on the information supplied by the Ministry of Finance).

	2018	2019	
Change, % of GDP	–0.2	–0.4	–0.1
Deviation from the adjustment requirement, % of GDP	–0.2	0.2	0.6
Cumulative deviation (two-year average)		0.0	0.4

*The estimate is based on the NAOF's structural balance calculations. The adjustment requirement takes into account the 0.5 percentage point flexibility granted under the structural reform clause. A negative adjustment requirement means that the structural balance is allowed to deteriorate.
**In the case of the structural balance, a significant deviation is a deviation of at least 0.5 percentage points from the requirement in one year or a cumulative deviation of 0.25 percentage points as the average of two years. A negative deviation means that the structural balance was below the adjustment requirement and there was no deviation as referred to in the rules.

Appended Table 2: Growth in central government expenditure, limit for an increase in expenditure, and deviation. The NAOF's calculations (based on the information supplied by the Ministry of Finance).

	2018	2019	2020
(Nominal) growth in total spending, calculated in accordance with the expenditure benchmark, %	3.3	3.8	3.4
(Nominal) limit for an increase in expenditure, %	2.3	2.9	1.9
Deviation			
Difference between the expenditure benchmark and the increase in expenditure, % points	–0.9	–0.9	–1.6
Deviation, € billion	–1.1	–1.1	–1.9
GDP, € billion	234.5	242.1	249.3
Deviation, % of GDP*	–0.5	–0.4	–0.8
Is the deviation significant (< –0.5)?**	No	No	Yes
Cumulative deviation		–0.5	–0.6
Is the cumulative deviation significant (< –0.25)?**		Yes	Yes

*A positive figure means that the expenditure is lower than what is permitted under the expenditure benchmark, while a negative figure means that the limit has been exceeded.
***In the case of the expenditure benchmark, a significant deviation means a deviation (in euro terms) which is under –0.5 % of GDP in one year or a cumulative deviation of –0.25% as the average of two years.

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