

Conclusions and recommendations of the National Audit Office

Sustainability assessments of general government finances in the knowledge base of economic policy

Sustainability of general government finances and one of its indicators, sustainability gap, have for years been important themes in economic policy debate. Sustainability gap has also played a key role in the justifications for the fiscal policy stance and structural reforms. According to forecasts, the ageing of the population will continue and therefore providing a true and fair picture of the outlook of general government finances will also continue to be a topical theme in the future. The purpose of this audit was to evaluate sustainability calculations produced by the Ministry of Finance, reporting on public finance sustainability, and the use of sustainability indicators in the steering of fiscal policy.

Based on the audit, the sustainability of public finances should be assessed more extensively. Reporting, which has so far focused on the long-term indicator S2, should be enriched with a medium-term S1 indicator covering approximately the upcoming 15 years. Using these both simultaneously would draw a better picture of the timeframe in which the sustainability challenges are occurring. In the audit, sustainability calculations of the Ministry of Finance were generally found to be carefully prepared, but some issues were also identified. Going forward, it should also be ensured that sustainability information is reported to Parliament as extensively as possible.

Assessment of the sustainability of public finances should be diversified and sustainability reporting should be enhanced

Using several indicators in parallel would generate more detailed information about the timeframe of possible sustainability issues and about the sustainability impacts of different policy measures. Specifying the timeframe would also facilitate the assessment of the urgency of necessary policy measures: the conclusions can vary depending on whether the issue relates, for example, to an estimated development in the next decade or to a change that will not occur until after several decades.

In Finland, the long-term sustainability indicator (S2) has traditionally been an important theme in economic policy debate. However, it does not give a sufficient picture of the sustainability of public finances as it does not provide information about the timeframe in which possible sustainability challenges are occurring. Finnish sustainability analyses lack an S1 indicator looking around 15 years into the future, which would substantially enrich the picture of the sustainability of public finances. The development of age-related expenditure can also be assessed more reliably for the time period covered by the S1 indicator compared with the S2 period, which is in principle infinite. The use of indicators covering the period of 15 years alongside the S2 indicator has become an established practice, for example, in assessments made by the European Commission and in reporting by the Swedish government.

In addition to a more diverse use of sustainability indicators, it would also be useful to supplement sustainability reporting with information about the sustainability of the subsectors of public finances and comparisons about the differences between indicators produced by

various parties. The communication regarding different scenarios and the magnitude of sustainability risks should also be improved. The picture of the sustainability situation could also be broadened by analysing existing information on public wealth and contingent liabilities in connection with the sustainability assessment.

The reporting by the Ministry of Finance has improved in recent years as regards the comprehensiveness of sensitivity analyses and methodology descriptions. The methodology description published by the Ministry concerning the sustainability gap calculation is useful and has increased the transparency of the calculation. Sustainability assessments of the Ministry have been made with high expertise but quantitatively limited resources.

The Ministry publishes more detailed sustainability assessments as part of its forecast publications. At the same time, sustainability is only cursorily discussed in the General Government Fiscal Plan, the content of which is regulated by decree and which is a parliamentary document discussed in Parliament. The current legislation does not include an obligation to analyse sustainability in the General Government Fiscal Plan. The sustainability of public finances will have great significance in the upcoming decades and therefore extensive reporting of sustainability information to Parliament should be secured through legislation. It would be appropriate to include in fiscal policy legislation the obligation to comprehensively cover the sustainability of public finances in the General Government Fiscal Plan.

The long-term sustainability gap indicator is not applicable as an independent fiscal policy target

There is no need to set separate targets for the development of sustainability indicators in the fiscal policy framework. Due to their nature, sustainability assessments are best suited for the assessment of the need for structural reforms. It is also important that measures supporting the sustainability of public finances are also taken into consideration in economic policy targets, such as employment rate targets.

The use of sustainability indicators as independent targets is limited by the great uncertainty involved in them. In addition, some of the factors that have a material effect on sustainability are largely outside the direct influence of political decision-making. Changes in calculation methods and assumptions can result in substantial fluctuations in the value of the long-term sustainability indicator. In addition, sustainability indicators are also built in the EU-level short-term and medium-term fiscal policy regulation, which also decreases the need to set separate targets for the development of these indicators.

Sustainability gap calculations have been produced carefully, yet their accuracy has certain problems

The audit evaluated the sustainability calculations produced by the Ministry of Finance in spring 2019, which was also the most recent sustainability assessment available at the time of the drafting of the new Government Programme. Overall, the calculations have been carefully prepared, but some issues were identified. The issues partly concerned the simulations of the development of age-related expenditure, which were not found fully reliable. The social security expenditure analysis model ('the SOME model') was in general considered non-transparent by the users: the users have not always been able to verify the accuracy of all measures using this model. Due to the issues identified in the audit, the spring 2019 calculations overestimated the sustainability gap; however, this did not affect the overall picture formed of the sustainability situation. While the audit was still ongoing, the Ministry began to improve its calculation model based on the observations made.

The underlying assumptions used as a basis of the sustainability gap calculation by the Ministry of Finance partly deviate from the assumptions used in the sustainability assessments jointly produced by EU Member States and the Commission. The main reason for the deviations is the use of different population projections in the calculations. However, compared with the assessments prepared at the EU level, the assumptions used in the calculations by the Ministry of Finance do not overall cause a systematic bias in the sustainability calculation results. Nevertheless, it would be useful to interpret the baseline scenario used in the sustainability calculations as just one, albeit well-justified, scenario among many instead of being considered the most likely scenario.

Recommendations of the National Audit Office

Based on the audit, the National Audit Office recommends that:

1. the Ministry of Finance develops its regular assessment of and reporting on sustainability of public finances, including by enriching it with a sustainability indicator covering approximately the upcoming 15 years (e.g. with the S1 indicator in accordance with the definition by the European Commission);
2. the Ministry of Finance, together with the Ministry of Social Affairs and Health and the National Institute for Health and Welfare, ensures that the calculation and simulation methodologies are up-to-date and transparent;
3. the Government prepares an amendment to fiscal policy legislation so it would be obligatory to comprehensively cover the sustainability of public finances in the General Government Fiscal Plan, including sustainability assessments covering several different time periods and scenarios.