



Description of methods and evidence: Regular assessment tasks related to fiscal policy monitoring



Audit and monitoring instructions of
the National Audit Office of Finland
Description of methods and evidence:
Regular assessment tasks related to fiscal policy monitoring

7.10.2019

Description of methods and evidence: Regular assessment tasks related to fiscal policy monitoring

Reg. no. 284/50/2019

The National Audit Office of Finland (NAOF) is Finland's Supreme Audit Institution and its position is laid down in section 90 of the Constitution of Finland. It operates in affiliation with Parliament and audits the legality and appropriateness of the state's financial management and compliance with the state budget. The NAOF also monitors fiscal policy and oversees election campaign and political party funding.

The National Audit Office monitors and assesses fiscal policy as a national independent fiscal institution referred to in the European Stability Treaty (Fiscal Compact) and European Union law. Provisions on the monitoring task are laid down in the Act on the National Audit Office of Finland (676/2000) and the Fiscal Policy Act (869/2012).

Under Section 20(3) of the Act on the National Audit Office of Finland, the NAOF confirms this description of methods and evidence, which defines the fiscal policy monitoring tasks regularly performed by the NAOF and presents the assessment criteria, methods, and evidence the NAOF uses in performing its tasks.

Helsinki, 7 October 2019

Tytti Yli-Viikari
Auditor General

Matti Okko
Director

Contents

1	Fiscal Policy Monitoring.....	4
	Areas of fiscal policy monitoring at the NAOF	4
	Fiscal policy monitoring in literature.....	4
	Fiscal policy monitoring is governed by regulations	4
2	Assessing compliance with the Stability and Growth Pact	6
	Compliance with the preventive arm	6
	Monitoring of the correction mechanism	7
	Compliance with the corrective arm	8
3	Preparation and implementation of the General Government Fiscal Plan	10
	Compliance of the contents with legislation	10
	Monitoring of the fiscal balance and debt objectives	12
4	Assessment of forecasts issued by the Ministry of Finance.....	13
	Assessing the realism of the forecasts	13
	Ex-post assessment of the reliability of forecasts.....	13
5	Assessing compliance with central government spending limits.....	15
6	Assessing the fiscal policy stance.....	17

1 Fiscal Policy Monitoring

Areas of fiscal policy monitoring at the NAOF

- 1.1 The National Audit Office performs its fiscal policy monitoring task by regularly assessing the following main areas:
 - compliance with the rules of the EU Stability and Growth Pact
 - drafting and implementation of the General Government Fiscal Plan
 - compliance with central government spending limits
 - realism and reliability of the forecasts by the Ministry of Finance
 - fiscal policy stance.
- 1.2 These tasks are described in Sections 2–6, which present the grounds for each assessment task, as well as the questions, assessment criteria, and methods related to the tasks. In addition to these areas, if necessary, the NAOF also assesses other topics related to fiscal and economic policy as part of its fiscal policy monitoring.

Fiscal policy monitoring in literature

- 1.3 Independent fiscal institutions are usually defined as non-partisan, independent, publicly financed institutions aiming to increase the commitment of policy-makers to sustainable management of public finances.
- 1.4 According to the definition by the European Commission, fiscal institutions are part of fiscal governance, which, in addition to fiscal institutions, includes fiscal rules and medium-term budgetary frameworks. Fiscal governance measures aim at responding to the tendency of governments to allow deficit and public debt levels to increase (*deficit bias*), mitigating the pro-cyclicality of fiscal policy, and increasing the efficiency of public spending. Fiscal governance has been strengthened considerably in the 2000s, particularly in the European Union, but the amount of monitoring and regulation is increasing outside the EU as well.
- 1.5 The institution responsible for fiscal policy monitoring strives to influence fiscal policy by providing high-quality analyses and expert assessments. An essential part of the role of a fiscal institution is to inform the general public about the fiscal policy pursued, increase the transparency of the policy, and thereby to raise the level of public debate and encourage the decision-makers to act responsibly.
- 1.6 The concrete tasks of a fiscal institution may include, for example:
 - both ex-ante and ex-post assessment of compliance with fiscal rules and other national objectives
 - preparation or assessment of forecasts
 - assessment of long-term sustainability
 - assessment of short and medium-term macroeconomic stability
 - assessment of the impacts of fiscal policy measures (policy costing).
- 1.7 The fiscal institution can assess the measures taken by the Government and also give recommendations for measures. The fiscal institution can propose improvements to fiscal rules or contribute to the flexibility of the rules by making situation or country-specific assessments.
- 1.8 In short, to be able to perform its fiscal policy monitoring duty, the fiscal institution must have a statutory mandate, it must be independent and non-partisan, it must have a channel through which it can communicate with both decision-makers and the general public, and its employees responsible for the monitoring must have macroeconomic competence for making assessments and giving any recommendations. The authority and influence of the fiscal institution are increased by competence and a good reputation.

Fiscal policy monitoring is governed by regulations

- 1.9 Fiscal policy and its monitoring in Finland are governed by EU legislation, agreements between Member States, and national legislation based on these. Below is a list of the most essential regulations governing fiscal policy monitoring and a short description of their interconnections.
 - Act on the National Audit Office (676/2000)

- Act on the implementation of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, the implementation of Treaty provisions of a legislative nature as well as requirements concerning multi-annual budgetary frameworks (869/2012), as amended by acts 79/2015 and 18/2017, **so-called Fiscal Policy Act**
 - The Decree on the General Government Fiscal Plan (120/2014), as amended by decrees 225/2015, 601/2017, and 279/2018
 - Government decree on the implementation of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, the implementation of regulations under the legislation of the Treaty, application of the Treaty, and the entry into force of the act on requirements concerning multi-annual budgetary frameworks (1030/2012)
 - Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (24/2013), **so-called Fiscal Compact**
 - Regulation (EU) No. 473/2013 of the European Parliament and of the Council on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area, **so-called Regulation on Monitoring Draft Budgetary Plans**
 - Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States, so-called Budgetary Frameworks Directive.
- 1.10 The provisions of the Fiscal Compact (24/2013) that fall within the scope of law are implemented by the national fiscal policy act. Those provisions of the Fiscal Compact that do not fall within the scope of law are in force by virtue of a decree (1030/2012). The Fiscal Compact imposes, for example, an obligation to provide for national fiscal rules and establish a national fiscal institution.
- 1.11 The Fiscal Policy Act also lays down requirements for multi-annual budgetary frameworks through an authorization to issue a decree. Under the Fiscal Policy Act, the Government has issued the Decree on the General Government Fiscal Plan (120/2014) and its amending decrees (601/2017, 279/2018). The Decree on the General Government Fiscal Plan establishes provisions for the parts of the Budgetary Frameworks Directive (2011/85/EU) that apply to the fiscal plan.
- 1.12 The tasks of the independent institutions monitoring compliance with the fiscal rules are laid down in the Budgetary Plans Monitoring Regulation (EU No. 473/2013).¹

Fiscal policy monitoring tasks based on legislation

- 1.13 Under national legislation, the National Audit Office
- monitors compliance with the Fiscal Policy Act and the provisions issued under it,
 - issues opinions on the sufficiency of corrective measures,
 - reports on its conclusions to the Government.
- 1.14 The Budgetary Plans Monitoring Regulation lays down tasks for the independent institutions that monitor compliance with the fiscal rules. The NAOF's fiscal policy monitoring can be considered an institution as referred to in the Regulation based on the NAOF's monitoring task laid down in the Fiscal Policy Act, for example. Under the Regulation, the independent institutions shall:
- monitor compliance with fiscal policy rules, and
 - if necessary, provide public assessments related to them.

¹ Regulations are legal acts that apply automatically and uniformly to all EU countries as soon as they enter into force, without needing to be transposed into national law. They are binding in their entirety on all EU countries. Directives require EU countries to achieve a certain result, but leave them free to choose how to do so. EU countries must adopt measures to transpose them into national law. https://ec.europa.eu/info/law/law-making-process/types-eu-law_fi.

2 Assessing compliance with the Stability and Growth Pact

- 2.1 The fiscal rules of the European Union are compiled in the Stability and Growth Pact, whose compliance is monitored in Finland by the National Audit Office (NAOF). The European Commission prepares a regularly updated *Vade Mecum on the Stability and Growth Pact*, which includes the Commission's interpretation on the assessment of compliance with the Pact. In addition to the Commission, the Finnish Ministry of Finance and the National Audit Office of Finland also base their assessments on compliance with the Pact on this *vade mecum*.
- 2.2 As a rule, compliance with the Stability and Growth Pact is assessed within the scope of the European Semester in spring and autumn. In spring, the Ministry of Finance provides the Commission with a stability programme, which includes, for example, an assessment of compliance with the rules of the Stability and Growth Pact (in years $t-1$, t , $t+1$). In autumn, the Ministry of Finance draws up a draft budgetary plan, which accordingly includes an assessment of compliance with the rules (at least in years t and $t+1$). Both the EU bodies (the Commission and the Council) and the NAOF assess and comment on these publications and assessments. The NAOF issues an independent assessment of compliance with the rules based on the above-mentioned documents, their background materials, and other necessary materials (including the forecast by the Ministry of Finance, statistical data, and any evidence provided by the Commission).
- 2.3 The Stability and Growth Pact consists of a preventive arm and a corrective arm, which will be dealt with separately in greater detail in the following.

Compliance with the preventive arm

Grounds

- 2.4 Compliance with the preventive arm of the Stability and Growth Pact is assessed on the basis of two complementary pillars. These are the Medium Term Objective (MTO) for the general government finances, which is nationally set as the target level for structural balance, and the Expenditure Benchmark (EPB), which sets a limit for the growth of public spending. The assessment evaluates whether these rules have been complied with or deviated from. The significance of the deviation plays a key role, as only a significant deviation can lead to infringement of the rules and follow-up procedures. Compliance with the preventive arm is assessed through an overall assessment which takes both these pillars into account, e.g. if they are in contradiction.

Questions

- 2.5
 - 1 Have the general government finances developed in accordance with the criteria applied to the structural balance and the expenditure benchmark?
 - 2 Is there a risk that Finland may breach the rules of the preventive arm in the near future?

Criteria

- 2.6 The assessment of compliance with the Stability and Growth Pact is based on relevant legislation, the Commission's interpretation of compliance with the rules as set out in the *Vade Mecum on the Stability and Growth Pact*, and any other available evidence.

Methods

- 2.7 The assessment of compliance with the rules is based primarily on the evidence provided by the Ministry of Finance. The assessment process can be divided into two steps. In the first step, the National Audit Office verifies the quality of the calculations of the Ministry of Finance by making corresponding calculations based on the same data. When making the calculations, the NAOF follows the methods agreed by the Commission and the Member States. In the second step, the NAOF makes an assessment of compliance with the rules based on the results achieved and the instructions given in the *Vade Mecum on the Stability and Growth Pact*. Mere calculations seldom reveal whether the rules have been complied with. This is because the interpretation of the framework (*Vade Mecum*

on the *Stability and Growth Pact*) includes many details, such as comparing the development in each year often with the previous year and examining the annual change in relation to the required change (adjustment requirement).

- 2.8 In spring, the assessment relates to years $t-1$ and $t+1$. The spring assessment is an ex-post assessment of whether the rules were complied with in the previous year and also an ex-ante assessment of the current and following year. The autumn assessment is an ex-ante assessment of (at least) the current and following year (t , $t+1$).
- 2.9 If an ex-post assessment detects a significant deviation, it may lead to the launch of a correction mechanism (*Significant Deviation Procedure*) and later on to sanctions. An ex-ante assessment cannot lead to the launch of the correction mechanism. The ex-ante assessment is important, as fiscal policy can influence future development. If it seems that the medium-term objective will not be achieved, fiscal policy can help general government finances to get to the path leading to the objective.
- 2.10 The calculations and the assessment of compliance with the rules should take the Commission's corresponding calculations and assessments into account. However, the Commission's figures are based on the Commission's forecast, whereas the figures of the Ministry of Finance and the NAOF are based on the forecast of the Ministry of Finance. The figures are thus different. Due to time constraints, the NAOF's publications cannot necessarily compare up-to-date calculations of the different parties, as the Commission's figures and assessment are often published at about the same time or only shortly before the NAOF's assessment.

Reporting

- 2.11 The assessment of compliance with the preventive arm of the *Stability and Growth Pact* is published twice a year in fiscal policy monitoring reports. The spring report presents an ex-post assessment of the previous year and an assessment of whether Finland risks breaching the criteria in the future (during the current and the following year). The autumn report presents an ex-ante assessment of the current and the following year. When publishing its assessments, the NAOF also publishes the results of its calculations in Excel format on its website.

Monitoring of the correction mechanism

Grounds

- 2.12 Under the Fiscal Policy Act (869/2012), if the correction mechanism is launched, the fiscal policy monitoring task includes assessment of the sufficiency of the corrective measures. The mechanism is launched if a significant deviation from the medium-term objective is found, and the EU Council recommends that corrective measures should be taken. The Government shall follow the NAOF's public opinions on the sufficiency of the corrective measures. This underlines the NAOF's accountability in performing its monitoring task and the importance of basing the NAOF's public opinions on careful analysis. To ensure transparency and systematic analyses, it is important to develop tools for assessing the sufficiency of the corrective measures.
- 2.13 To implement the responsibility, transparency and openness of the monitoring task, the fiscal policy monitoring function must have well-defined and publishable methods available for assessing fiscal policy measures. A framework suitable for assessing policy impacts should also take into account both different policy measures and their impacts on the general government fiscal position in the medium term.

Question

- 2.14 Are the measures decided by the Government sufficient to bring Finland to a path leading to the medium-term objective (MTO)?

Criteria

- 2.16 The measures are sufficient if they bring the forecast development of the general government fiscal position back to the target path.

Methods

- 2.17 A transparent and publishable framework based on economic modelling is developed for the assessment of the sufficiency of corrective measures. Microsimulations can also be utilized as part of the assessment. The development work utilizes both external research projects and the NAOF's own analyses. The models and methods applied in the assessment are published on the NAOF's website.
- 2.18 The framework used in the assessment of fiscal policy measures must include a sufficiently detailed description of general government revenue and expenditure items. In addition to the different parts of general government, the framework must describe the development of tax bases. Estimations based on external modelling outside the framework enable indicative assessment of the impacts of tax rates and public demand on tax bases and GDP. The framework makes it possible to assess changes in tax bases and the impacts of changes in fiscal policy on the macro variables for measuring the state of general government finances.
- 2.19 The method framework is intended particularly for a situation where the correction mechanism is launched in Finland and where the NAOF, within the scope of its statutory task, must present its assessment of the sufficiency and credibility of policy measures. In the future, the framework can also be utilized, for example, in the assessment of policy measures on the closing of the sustainability gap or in similar situations where the NAOF is expected to present its view of the impact of fiscal policy measures on the general government fiscal position in the short and medium term and on long-term sustainability. It can also be utilized in the assessment of the credibility of the impact assessments made by the Ministry of Finance.

Reporting

- 2.20 The NAOF reports on the results of the assessment as part of its regular reporting. If necessary, the results are published in separate memoranda. The models and methods applied in the assessment are published on the NAOF's website.

Compliance with the corrective arm

Grounds

- 2.21 The corrective arm of the EU Stability and Growth Pact examines the general government debt and deficit criteria. Under the deficit criterion, general government nominal deficit may not exceed 3 per cent of GDP. Under the debt criterion, general government debt of a Member State may not exceed 60 per cent of GDP. If a Member State is in breach of either or both of the criteria of the corrective arm, it may be subjected to the excessive deficit procedure (EDP). In the case of the deficit criterion, the EDP can be launched based on the actual and planned figures. In the case of the debt criterion, it can be launched based on the actual figures. Exceeding the nominal limits set for both criteria may, however, prompt the Commission to issue a report referred to in Article 126(3) on the basis of not only the actual figures but also the planned figures or forecasts. In the report, the Commission will state the reasons for launching or not launching the excessive deficit procedure. As part of its fiscal policy monitoring task, the NAOF assesses fulfilment of the criteria of the corrective arm as well as the Commission's reports on compliance with the criteria.

Questions

- 2.22
- 1 Has Finland complied with the corrective arm of the Stability and Growth Pact?
 - 2 Is there a risk that Finland may breach the rules of the corrective arm in the future?

Criteria

2.24 Deficit criterion

Breaching the nominal deficit criterion set for general government finances does not automatically mean that the excessive deficit procedure (EDP) will be launched. If the excess of the 3 per cent limit is small, temporary and exceptional, the Member State is deemed to comply with the criterion. Excess of the deficit criterion is considered temporary if, according to the Commission's forecast, the deficit will drop under the 3 per cent limit. Moreover, the assessment of the deficit criterion also takes into account the exceptionality of the excess, such as a severe economic downturn. A more detailed description of the technical application of the assessment criteria can be found in the European Commission's *Vade Mecum on the Stability and Growth Pact*.

2.25 Debt criterion

The following factors are considered when compliance with the debt criterion is assessed:

- 1 Does the general government debt exceed 60 per cent of GDP at the time of the assessment?
- 2 If it does, the debt development is examined by means of a backward-looking criterion to see how the debt has developed during the past few years.
- 3 a) If the debt exceeds the backward-looking criterion, the two-year debt forecast is examined on the basis of the forward-looking criterion.
b) It is also determined whether the excess of the debt criterion results from the economic cycles by calculating the cyclically adjusted debt.

Methods and data

- 2.26 The assessment of compliance with the general government debt and deficit criteria is based on the forecasts by the Ministry of Finance and the European Commission, and on official statistics. The criteria and the assessment of compliance with them is described in greater detail in *Vade Mecum on the Stability and Growth Pact*.

Reporting

- 2.27 An assessment of compliance with the corrective arm of the Stability and Growth Pact is published twice a year in fiscal policy monitoring reports. The spring report presents an ex-post assessment of compliance with the general government debt and deficit rules in the previous year and of whether there is a risk of breach of the criteria in the future (during the current and the following year). The autumn report presents an ex-ante assessment of the current and the following year. If necessary, compliance with the corrective arm is also assessed at other times if the Commission presents grounds for launching the excessive deficit procedure in its report according to Article 126(3).

3 Preparation and implementation of the General Government Fiscal Plan

Compliance of the contents with legislation

Grounds

- 3.1 In connection with the national implementation of the Budgetary Frameworks Directive (2011/85/EU), the Government issued the Decree on the General Government Fiscal Plan (120/2014) under the Fiscal Policy Act in February 2014. Under the decree, steering of general government finances shall have a more comprehensive and long-term basis. The General Government Fiscal Plan shall contain sections on central government finances, local government finances, statutory employment pension institutions, and other social security funds. The General Government Fiscal Plan contains the national fiscal policy rules, whose compliance shall be assessed particularly by the national fiscal institution, i.e. the National Audit Office. The plan supports the achievement of the medium-term objective set for the general government structural fiscal position. As the Decree on the General Government Fiscal Plan has been issued under the Fiscal Policy Act, the NAOF shall monitor the preparation and implementation of the Plan².
- 3.2 According to the practice adopted by the Government, the stability programme submitted to the European Commission has been appended to the General Government Fiscal Plan issued in spring. The Fiscal Policy Act does not lay down provisions concerning the preparation or submission of the stability programme or appending it to the Plan. Monitoring the contents of the stability programme is therefore not directly included in the NAOF's statutory duties. However, the stability programme has several links to the actual General Government Fiscal Plan and to the NAOF's duties in monitoring compliance with the fiscal framework. The NAOF can therefore also assess the contents of the stability programme, if necessary.

Question

- 3.3 Do the contents of the General Government Fiscal Plan submitted to Parliament conform to the requirements set by the valid Decree on the General Government Fiscal Plan and the Fiscal Policy Act?

Criteria

- 3.4 The Decree on the General Government Fiscal Plan (last amended on 8 May 2018) sets out the requirements for the information contents on which the assessment is based. They are assessed based on both the letter of the Decree and the purpose of the provisions, i.e. taking also into account the clarity and intelligibility of the information provided as well as the materiality of any defects. If necessary, further support for the interpretations can be provided by the Budgetary Frameworks Directive, whose national implementation the Decree on the General Government Fiscal Plan is largely related to. In short, the requirements set for the contents are as follows:
 - 3.4.1 The General Government Fiscal Plan shall set a multi-annual target path for the general government deficit and a parliamentary term objective for the general government sub-sectors. These should lead to the achievement of the objective set for structural deficit in normal conditions.
 - 3.4.2 In addition, the General Government Fiscal Plan shall set a cap in euros for the change in local government expenditure caused by central government measures. The Plan shall also set multi-annual objectives corresponding to the deficit objectives for the ratio of general government debt and public spending to GDP.

²The Fiscal Policy Act states as follows: "As part of the audit of the management of central government finances, the National Audit Office shall monitor compliance with this Act and the provisions issued under it."

- 3.4.3 The Plan shall present assessments of the key revenue and expenditure items of general government and its sub-sectors. The assessments shall be based on two assumptions: 1) that the legislation affecting revenue and expenditure is not amended, and 2) that the legislation affecting revenue and expenditure is amended as specified by the Government. The Plan shall describe the impact of both options on the medium-term structural fiscal position and long-term sustainability of general government finances. The Plan shall also describe the estimated economic impact of the measures specified by the Government on the achievement of the fiscal position objectives.
 - 3.4.4 The General Government Fiscal Plan shall present a comparison between the most recent macroeconomic and budgetary forecast of the Ministry of Finances and the European Commission, and explain the differences between the assumptions on which the forecasts are based, if they are significant.
 - 3.4.5 The Plan shall describe the impact of different growth and interest assumptions on the forecast and the key figures of general government finances.
 - 3.4.6 The general government units that are not part of regular budgets at the sub-sector level shall be listed and published in connection with the General Government Fiscal Plan. The Plan shall describe the combined impact of these units on general government fiscal position and debt.
 - 3.4.7 A list of the units referred to in Section 6 shall be published in connection with the budget proposal. The budget proposal shall also describe the combined impact of these units on general government fiscal position and debt.
 - 3.4.8 The General Government Fiscal Plan shall be taken into account in the preparation of the budget proposal. The budget proposal shall justify any significant deviations from the previous General Government Fiscal Plan and assess the economic impact of the deviations. In addition, the budget proposal shall present the differences from the previous General Government Fiscal Plan resulting from changes in the economic forecast.
- 3.5 There are slightly different requirements for the contents of the different General Government Fiscal Plans of the parliamentary term. The requirements set for the last, so-called technical General Government Fiscal Plan are less stringent: it does not have to set objectives and thereby no measures to achieve them, either.
- 3.6 The Fiscal Policy Act requires, moreover, that the Government should set a medium-term objective for general government structural fiscal position in compliance with the Fiscal Compact (the Compact also includes various criteria for minimum objective options, the interpretation of which falls within the responsibility of the NAOF). In practice, the objective in question is set by the General Government Fiscal Plan.

Evidence and methods

- 3.7 The evidence consists of the General Government Fiscal Plan, the stability programme, the budget proposal, and, where appropriate, background materials that were used in their preparation and that are requested from the Ministry of Finance.
- 3.8 The method primarily applied is document analysis. If necessary, compliance with legislation is examined by means of quantitative analysis.

Reporting

- 3.9 To ensure that the assessment is up-to-date, the NAOF issues a general assessment of compliance of the most recent General Government Fiscal Plan with legislation in the first fiscal policy monitoring report or memorandum following the issue of the Plan. Other findings are reported flexibly in fiscal policy monitoring reports and memoranda in accordance with the publication formats and observations made.

Monitoring of the fiscal balance and debt objectives

Grounds

- 3.10 The Decree on the General Government Fiscal Plan obliges the Government to set sector-specific fiscal position objectives in order for the general government to achieve the medium-term objective (MTO). The Government shall set a multi-annual target path for general government deficit and a parliamentary term objective for the general government sub-sectors. In addition, the Government shall set multi-annual objectives corresponding to the deficit objective for the ratio of general government debt and public spending to GDP. In order to be able to make conclusions about the status of the achievement of the MTO, for example, it is important to monitor the objectives.
- 3.11 Long-term sustainability can be defined as an ability to achieve the MTOs even in future. It is therefore important to monitor long-term sustainability even though legislation does not require separate objectives for it.

Question

- 3.12 Is it possible to achieve the fiscal position and debt objectives, and what are the factors that either promote or slow down the achievement of these objectives and favourable long-term development?

Criteria

- 3.13 Achievement of the binding MTO requires that Finland makes progress towards the fiscal balance objectives. In order for Finland to be able to achieve the MTO even in the future, general government finances must be managed sustainably even in the longer term.

Method and evidence

- 3.14 While monitoring the implementation of the General Government Fiscal Plan, the NAOF also assesses the achievement of the sector-specific fiscal balance and debt objectives, the prerequisites for achieving them, and the sustainability of the fiscal management. In its assessments, the NAOF utilizes forecasts and projections by various actors and, where appropriate, the NAOF's qualitative or quantitative assessments of the impacts of legislative measures and other initiatives on general government finances. The primary evidence consists of the Government decisions taken in connection with the General Government Fiscal Plan of the spring and the budget preparations in the autumn, including the related preparation materials, such as forecasts by the Ministry of Finance.

Reporting

- 3.15 The NAOF reports flexibly on its findings at least once a year in its fiscal policy monitoring reports and memoranda in accordance with the publication formats and the observations made. Parliamentary term or mid-term reports are the most extensive ones.

4 Assessment of forecasts issued by the Ministry of Finance

Grounds

- 4.1 In Finland, the forecasts on which fiscal policy is based are prepared by the Economics Department of the Ministry of Finance. Under the EU legislation, forecasting should be independent of budget preparations, for example. The arrangement in Finland is exceptional compared with the other Member States, but it is allowed. According to the national Decree on General Government Fiscal Plan, the Ministry of Finance shall take into account the NAOF's conclusions about the macroeconomic and budgetary forecast when preparing its economic forecasts.
- 4.2 The assessment of forecasts is described in greater detail in the Budgetary Frameworks Directive (2011/85/EU). According to the directive, the quality of official macroeconomic and budgetary forecasts is enhanced by regular, unbiased, and comprehensive evaluation. Thorough evaluation includes scrutiny of the economic assumptions, comparison with forecasts prepared by other institutions, and evaluation of past forecast performance.
- 4.3 The NAOF's evaluation work includes both ex-ante assessments of the realism of the forecasts and ex-post assessments of their reliability. These two types of assessments will be described in the following.

Assessing the realism of the forecasts

Question

- 4.4 Are the forecasts of the Ministry of Finance on which the fiscal policy is based realistic?

Criteria

- 4.5 A forecast can be considered realistic if it does not deviate significantly from corresponding forecasts of other economic forecasters.

Methods and evidence

- 4.6 The forecast by the Ministry of Finance is assessed in relation to those of other economic forecasters. The NAOF assesses the internal consistency and background assumptions of the forecast.

Reporting

- 4.7 The NAOF makes an ex-ante assessment of the forecasts' realism usually twice a year in connection with the spring and autumn fiscal policy monitoring reports. In spring, the NAOF assesses the forecast on which the General Government Fiscal Plan is based. In autumn, the NAOF assesses the forecast on which the Government's budget proposal and the draft budgetary plan are based. In addition, the Ministry of Finance is compared as a forecaster with other Finnish and foreign economic forecasters.

Ex-post assessment of the reliability of forecasts

Questions

- 4.8 The reliability of forecasts is assessed by means of the following questions and criteria:
 - 1 Have the forecasts prepared by the Ministry of Finance succeeded in forecasting future economic development at least as accurately as those of other major economic forecasters (accuracy)?
 - 2 Have the errors in the forecasts of the Ministry of Finance been temporally independent and non-persistent?
 - 3 Have the forecasts of the Ministry of Finance been unbiased?
 - 4 Have the forecasts of the Ministry of Finance encompassed the naïve forecast?

- 5 Have the forecasts of the Ministry of Finance covered all relevant information at the time of forecasting?
- 6 Has there been a significant bias affecting macroeconomic forecasts over a period of at least four consecutive years?

Methods and evidence

- 4.9 Assessment of the reliability of forecasts is based on a comparative evaluation which is based on statistical tests and in which the forecasts of the Ministry of Finance are also examined in relation to those of other forecasters and the actual statistical figures. The statistical tests used are, where applicable, the same ones that the European Commission uses to assess its own forecasts.
- 4.10 The methods and the evidence used are described in greater detail in the report of spring 2018: <https://www.vtv.fi/en/publications/fiscal-policy-evaluation-on-the-reliability-of-the-ministry-of-finance-macroeconomic-forecasts-the-short-term-forecasts-of-gdp-growth-unemployment-rate-and-inflation-for-the-years-1976-2016-under-r/>

Reporting

- 4.11 The findings are reported in monitoring reports and memoranda or in a separate report, depending on the extensiveness of the examination. It is not necessarily sensible to produce and report an overall assessment after each forecasting round, as the method focuses on assessing the reliability in the longer term, and the assessment is based on a long time series.

5 Assessing compliance with central government spending limits

Grounds

- 5.1 The spending limits procedure is the most important national fiscal policy instrument for controlling expenditure. The Government is committed to the central government spending limits procedure, which includes an expenditure limit to ensure that central government implements a responsible, long-term spending policy that promotes economic stability. The system is based on overall spending limits which are set for the parliamentary term, which are binding and set for real-term expenditure, and to which the necessary price and cost level adjustments and structural adjustments are made annually. The spending limits system limits the amount of expenditure in state budgets. The spending limits procedure sets a maximum for about 80 per cent of the state budget expenditure. The expenditure falling outside the central government spending limits includes, for example, expenditure that changes with economic cycles automatically (automatic stabilizers), interest paid on state debt, and financial investments. The decision on annual spending limits provides frameworks for the administrative branches, but only the overall limit set for the parliamentary term is binding. It is therefore possible to reallocate expenditure between the different administrative branches. In addition to the supplementary budget reserve, an unallocated reserve is left between the spending limits set for the parliamentary term and the sector-specific frameworks to be allocated later on.

Questions

- 5.2 Compliance with the spending limits is assessed by means of the following questions:
- 1 Were the central government spending limits prepared at the beginning of the parliamentary term in compliance with the policy lines set by the Government Programme and the principles of the spending limits system?
 - 2 Have the adjustments made to the spending limits complied with the principles of the spending limits system?
 - 3 Were the central government spending limits complied with in the preparation of the budget for the parliamentary term?
 - 4 Has the budget outturn also complied with the spending limits?
 - 5 Can it be stated at the end of the last year of the parliamentary term that the spending limits set for the parliamentary term were complied with?

Criteria

- 5.3 The principles and policy lines set out by the Government Programme and the spending limits manual.

Methods and evidence

- 5.4 Compliance with the spending limits at the Ministry of Finance is monitored by comparing the price and structure-adjusted spending limits with the budget. The National Audit Office makes its calculations by replicating the spending limits calculations using the evidence provided by the Ministry of Finance. The evidence includes
- 1 the spending limit decisions in the General Government Fiscal Plans,
 - 2 the budget proposals, budgets, and supplementary budgets including the preparation materials,
 - 3 the spreadsheets of the Ministry of Finance on spending limits adjustments,
 - 4 the Government's annual report, and
 - 5 the budget outturn statement in the final central government accounts.
- 5.5 The NAOF can also utilize the interpretations by the spending limits working group in its assessment. The calculations are made annually in connection with the General Government Fiscal Plan, the budget proposal, the budget, and each supplementary budget.

Reporting

- 5.6 As part of its reporting on fiscal policy monitoring, the NAOF publishes each spring and autumn its assessment of compliance with the spending limits and of whether the spending limits were prepared in compliance with the principles of the spending limits system.
- 5.7 As regards compliance with the spending limits, the spring report focuses on:
- assessment of the previous year's completed spending limits and budget preparation process as a whole,
 - assessment of the adjustments made to the spending limits of the parliamentary term in the General Government Fiscal Plan.
- 5.8 The autumn report focuses on:
- assessment of the preparation of the current year's supplementary budgets,
 - assessment of the preparation of the following year's budget.
- 5.9 The reports also pay attention to the development of expenditure outside the spending limits and to ensuring that the spending limits have not been bypassed by increasing the amount of expenditure outside them contrary to the principles of the spending limits system.

6 Assessing the fiscal policy stance

Grounds

- 6.1 When assessing and monitoring fiscal policy, it is useful to know whether the fiscal policy has been contractionary or expansionary, and what kind of development can be expected in the years to come based on forecasts and decisions taken. A fiscal policy that is strongly pro-cyclical (contractionary during an economic downturn or expansionary during an upturn) can strengthen harmful economic development.

Questions

- 6.2 What kind of fiscal policy has been pursued in the past few years and will be pursued in the near future – contractionary or expansionary?

Criteria and their sources

- 6.3 As a rule, the assessment is based on indicators used at the EU level but it is also possible to use other applicable indicators. Fiscal policy monitoring reports have assessed the fiscal policy stance based on two indicators: change in the structural (primary) balance (SPB) and change in discretionary policy (*Discretionary Fiscal Effort*, DFE).
- 6.4 There is uncertainty involved in the indicators, and they often produce at least slightly different views. The overall assessment should therefore rely on several indicators and, if necessary and possible, it should also be based on indicators other than those described in these guidelines. Indicators are described, for example, in publication 40/2017 of the Ministry of Finance, "*Finanssipolitiikan päätösperäisyyden arvioiminen – vaihtoehtoisten mittareiden esittely*".

Methods and evidence

- 6.5 Structural primary balance is calculated in the same way as structural balance in the assessment of compliance with the preventive arm of the Stability and Growth Pact, except that when the primary balance is calculated, all expenditure except interest payments are deducted from general government revenue. In the DFE indicator, the amount of discretionary measures and whether the amount is positive or negative are based on the difference between revenue and expenditure.
- 6.6 The data used in the calculation includes the NAOF's potential output calculations, statistical data, forecasts by the Ministry of Finance, and possibly other data separately requested from the Ministry. In addition to the publications mentioned above, descriptions of methods are also presented, for example, in *The Discretionary Fiscal Effort: an Assessment of Fiscal Policy and its Output Effect* by the European Commission.

Reporting

- 6.7 As a rule, the results of the calculation are reported once a year in the NAOF's fiscal policy monitoring reports, such as the mid-term and full-term report of the parliamentary term.

NATIONAL AUDIT OFFICE OF FINLAND
PORKKALANKATU 1, P.O.BOX 1119, FI-00101 HELSINKI
TEL. +358 9 4321 | WWW.VTV.FI | @VTV_FI