Separate report of the National Audit Office to Parliament: Fiscal policy monitoring report *2020*

NATIONAL AUDIT OFFICE´S REPORTS TO PARLIAMENT

R 21/2020 VP

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To Parliament

The National Audit Office monitors and assesses fiscal policy in its role as an independent national fiscal policy monitoring body as referred to in the EU's Fiscal Compact and the 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).

The monitoring comprises assessment of the setting and implementation of the rules and binding objectives that steer fiscal policy. It covers the monitoring of compliance with the Medium-Term Objective (MTO) set for general government finances and the related correction mechanism, monitoring of the preparation and implementation of the General Government Fiscal Plan, and monitoring of compliance with the EU Stability and Growth Pact. It also covers the assessment of the realism of the macroeconomic forecasts used in fiscal policy-making as well as the ex-post assessment of the reliability of the forecasts as laid down in the Government Decree on the General Government Fiscal Plan (120/2014, as amended by decree 601/2017). By monitoring fiscal policy, the National Audit Office promotes the transparency and intelligibility of the fiscal rules as well as stable and sustainable general government finances.

Under section 6 of the Act on the National Audit Office of Finland, the National Audit Office submits this separate report on fiscal policy monitoring to the 2020 parliamentary session.

Helsinki, 7 December 2020

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Main content

The coronavirus crisis caused a sharp fall in the national economy and general government finances at the beginning of 2020. The timing and scope of the measures taken by the Government to manage the crisis have been along the right lines. The impacts of the corona crisis should continue to be mitigated by an active fiscal policy. At the same time, it is important to adhere as far as possible to the established fiscal policy procedures, such as the spending limits rule of central government finances.

The Government's decision to dispense with compliance with the spending limits in 2020 was justified under the exceptional circumstances. In the budget proposal for 2021, the expenditure level has been changed within the flexibility provided by the spending limits rule, but flexibility has also been sought through exceptions to the spending limits rule. In order for the spending limits rule to remain a credible multi-annual planning instrument for central government finances, it is important to return to complying with it from 2021 onwards.

The General Government Fiscal Plan for 2021–2024, presented by the Government in the spring of 2020, did not include multi-annual objectives for general government finances. However, it complied with the requirements laid down by fiscal policy legislation in the prevailing exceptional circumstances. In the future, fiscal policy legislation should be specified to include more clearly defined provisions on exceptional situations similar to the present one.

The Government should return to normal multi-annual planning of general government finances – including the objectives set for general government finances – as soon as possible in view of the development of the crisis. After the crisis, it is important to steer general government finances to the path towards the budgetary balance objective. This requires systematic planning and commitment to medium-term financial planning. The Government can make use of the flexibility provided by fiscal policy legislation to set less strict objectives if the economic situation continues to be exceptional.

Because of the coronavirus crisis, the ratio of government debt to GDP will grow considerably in Finland but at a typical rate if compared with the other European countries. The government debt-to-GDP ratio should be stabilized according to the Government's objective, as the costs of refinancing debts falling due in the future involve a risk. The management of general government finances should therefore not rely on the assumption that interest rates will remain low permanently. Another reason for stabilizing the debt-to-GDP ratio is the growing pressure for increases in expenditure due to an ageing population. However, low interest rates support the general government's ability to manage the growing debt, and the large loans taken by the State of Finland in 2020 have been at zero interest in practice.

The sustainability roadmap that the Government has introduced in 2020 offers a starting point for stabilizing general government finances and improving sustainability in the long term. Nevertheless, the roadmap should be specified. The roadmap should also

prepare for the uncertainty included in different debt scenarios. In practice, this means that sensitivity analyses of the extent to which public finances should be strengthened to achieve a stable debt-to-GDP ratio should be presented in connection with the roadmap. In addition, the roadmap should pre-define practices for situations where the amount of required adjustment changes.

The original employment targets set out in the Government Programme were tied to normal global economic circumstances. In the autumn of 2020, the Government set an employment target that was more ambitious than the original one but had a more flexible timetable. It is good that the Government did not give up striving for higher employment because of the corona crisis.

The Government's sustainability roadmap defines the degree to which the new employment target aims to improve public finances. However, the sustainability roadmap and the employment measures defined in the budget session of autumn 2020 do not form a uniform whole. The National Audit Office assesses that the employment decisions taken so far during the parliamentary term improve general government finances only modestly.

There is a risk that the desired impacts on general government finances would not be achieved even if the employment rate improved as described in the sustainability roadmap. The current version of the roadmap is based on the optimistic assumption that the employment measures to be implemented will not cause any costs to general government.

The National Audit Office assesses that the economic forecast of the Ministry of Finance on which the budget for 2021 is based is realistic, considering the time when it was drawn up. Nevertheless, the corona crisis has made it difficult to forecast economic development, as the epidemic spreads unpredictably and has major economic impacts. Like other forecasters, the Ministry of Finance assumed in its forecast that the epidemic would not break out again. The development of both the epidemic and the restrictions applied in Finland and around the world has later increased the risk that the economic development will be weaker than forecast. On the other hand, because there have been positive vaccination news and vaccines will become available, it is also possible that the economic development will be more positive than forecast.

1 Fiscal policy decision-making has been dominated by the corona crisis

The coronavirus crisis caused a sharp fall in the national economy and general government finances at the beginning of 2020. The timing and scope of the measures taken by the Government as a result of the crisis have been along the right lines. The impacts of the corona crisis should continue to be mitigated by an active fiscal policy. At the same time, it is important to adhere as far as possible to the established fiscal policy procedures, such as the spending limits rule of central government finances.

The Government's decision to dispense with compliance with the spending limits in 2020 was justified under the exceptional circumstances. The expenditure level of the budget for 2021 has been changed within the flexibility provided by the spending limits rule, but flexibility has also been sought through exceptions to the spending limits rule. In order for the credibility of the spending limits rule to remain, it is important to return to complying with it from 2021 onwards.

The General Government Fiscal Plan for 2021–2024, presented by the Government in the spring of 2020, did not include multi-annual objectives for general government finances. However, it complied with the requirements set for fiscal policy legislation in the prevailing exceptional circumstances. In the future, fiscal policy legislation should be specified to include more clearly defined provisions on exceptional situations similar to the present one. The government should also return to the normal multi-annual planning of general government finances as soon as possible in view of the development of the crisis..

1.1 Due to the corona crisis, fiscal policy is implemented in a deep economic slump with falling general government finances

General government finances are expected to deteriorate considerably because of the corona crisis (Figure 1). General government finances are forecast to fall to a major deficit in 2020, and the deficit is expected to remain large even in the next few years. Accordingly, general government debt is expected to rise to 70 per cent of GDP in 2020, and the growth of the debt-to-GDP ratio is forecast to continue even in the coming years, although at a considerably slower rate. The economic forecasts and the realism of the forecast of the Ministry of Finance on which the state budget is based are discussed in greater detail in chapter 4.

The corona crisis strengthened the economic downturn that had already begun.

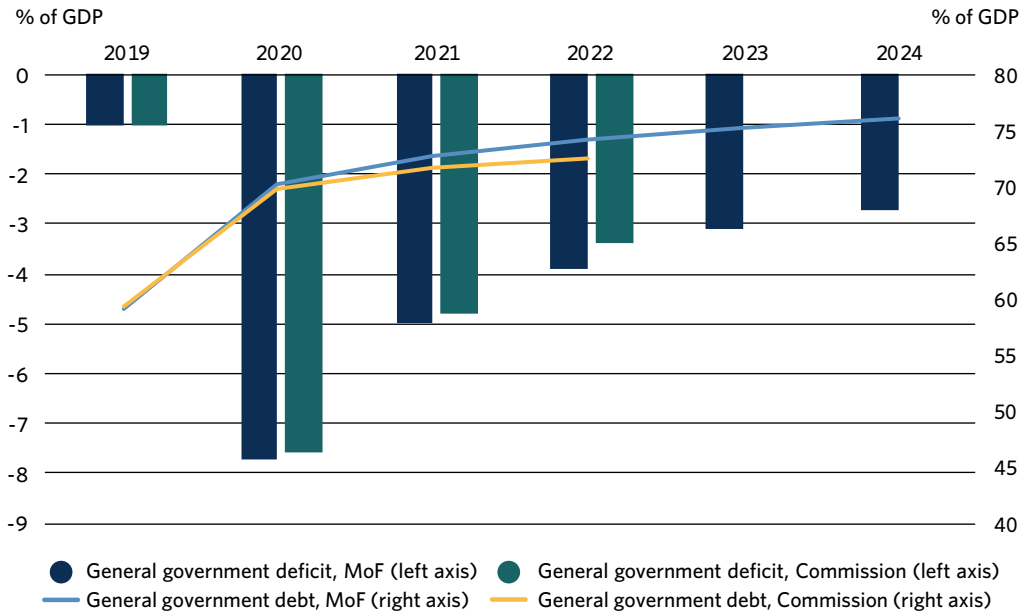

Figure 1: Development of general government deficit and debt (% of GDP) according to the forecasts by the Ministry of Finance (MoF) and the EU Commission.

The corona crisis changed the economic outlook abruptly. The economic heat map (Figure 2) used by the National Audit Office shows that the downturn that had already started in 2019 gained further impetus from the corona crisis, and in the second quarter of 2020, the economy sank clearly into a recession. According to the heat map, the cyclical conditions remained largely unchanged during the third quarter of 2020 compared with the previous quarter.

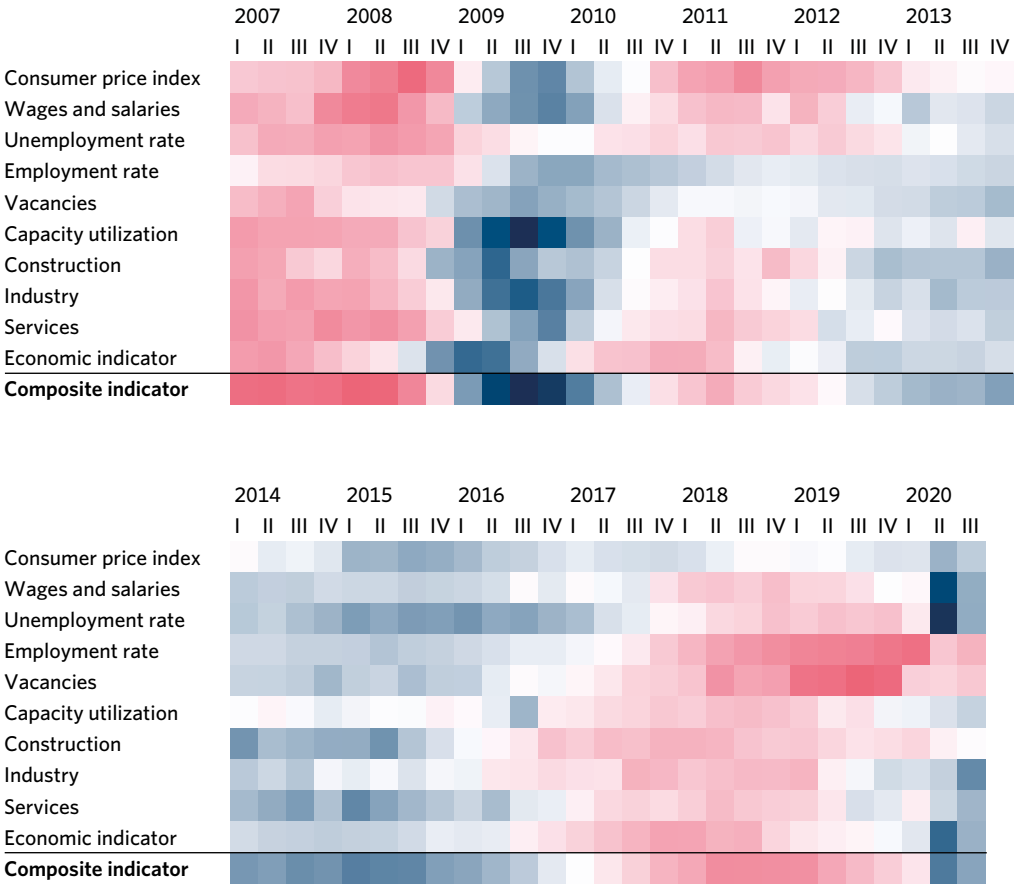

Figure 2: Economic heat map. The heat map consists of ten different cyclical indicators. Changes in the colours of the map reflect changes in the indicator values. Red represents a situation where, based on the indicator in question, the economic activities exceed the average level (e.g. the employment rate improves and salaries rise). Accordingly, blue represents a slowdown in economic growth. The higher the share of simultaneous red or blue indicators, the more likely the economy is to be experiencing good or bad times at the time. The individual indicators have been combined to form a composite indicator, the value of which is calculated as the average of the cyclical indicators. Source: National Audit Office of Finland (NAOF), Eelarvenõukogu, Macrobond, Statistics Finland, Ministry of Economic Affairs and Employment, and DG ECFIN.

At present, the composite indicator consisting of the heat map variables and the output gap estimate of the Ministry of Finance paint a quite similar picture of the development of the economic situation in recent years. According to the output gap estimate, the previous cyclical peak occurred slightly later than according to the composite indicator of the heat map of the National Audit Office. When examined over a longer period of time, the output gap estimate for 2020 is already approaching the rock bottom hit after the financial crisis.

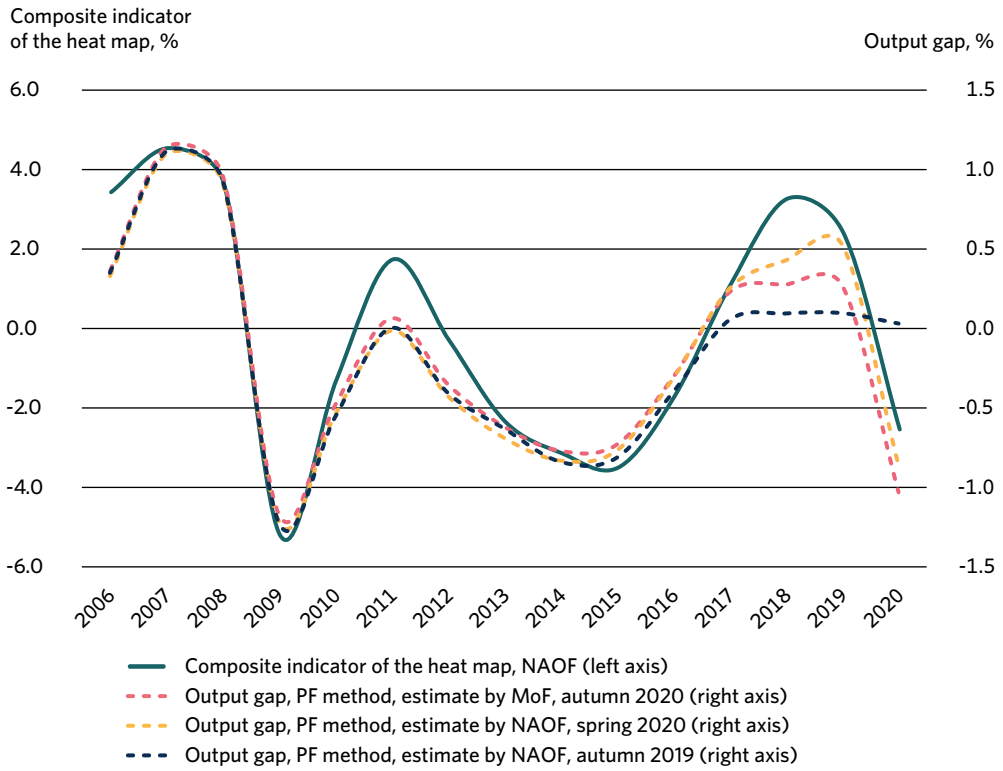

Figure 3: NAOF's composite indicator, MoF's output gap estimate in autumn 2020, and NAOF's output gap estimates in spring 2020 and autumn 2019. If the output gap estimate or heat map composite indicator is positive, the cyclical conditions are favourable, and if they are negative, there is an economic downturn.

Cyclical indicators based on the output gap and the heat map complement each other

In the EU, cyclical fluctuations are often monitored based on the output gap estimate. The output gap is the difference between potential output and the output at a given time, i.e. GDP. The output gap cannot be observed, but it is assessed using a shared statistical production function methodology of the EU. When the statistics used in the calculations are updated and supplemented, the result may change considerably (see Figure 3). It is therefore also good to compare the output gap estimate with other indicators illustrating the cyclical fluctuations, such as the composite indicator of the heat map.

The composite indicator of the heat map has proved to be more accurate in real time than the output gap estimate. When the output gap estimate has been updated, the picture it has painted has typically come closer to the one painted by the composite indicator. Compared with the output gap estimate, the difference and advantage of the heat map and the composite indicator calculated on the basis of it is that the heat map is based on statistical data, to which usually only minor updates are made.

Fiscal policy has been strongly expansionary

During 2020, the Government's fiscal policy has been strongly expansionary. Figure 4 shows the change in the cyclically adjusted primary balance and the cyclical indicator based on the output gap estimate. The change in the cyclically adjusted primary balance is the change in the general government fiscal position from the previous year, excluding the impact of economic cycles, and it describes the discretionary fiscal policy pursued by the Government. Thus, the figure illustrates the Government's discretionary fiscal policy in relation to the cyclical conditions based on the output gap estimate. This year's expansionary fiscal policy is largely due to the discretionary support and stimulus measures taken because of the corona crisis. As a result of the negative cyclical conditions, fiscal policy has also been counter-cyclical, smoothing the economic cycle.

According to the information currently available, many of the stimulus measures will come to an end next year, and therefore fiscal policy is here assessed to be contractionary in 2021. However, compared with 2019, fiscal policy will continue to be strongly expansionary next year. Assessments are highly uncertain, especially during cyclical changes, and therefore the output gap and primary balance estimates can still change considerably.

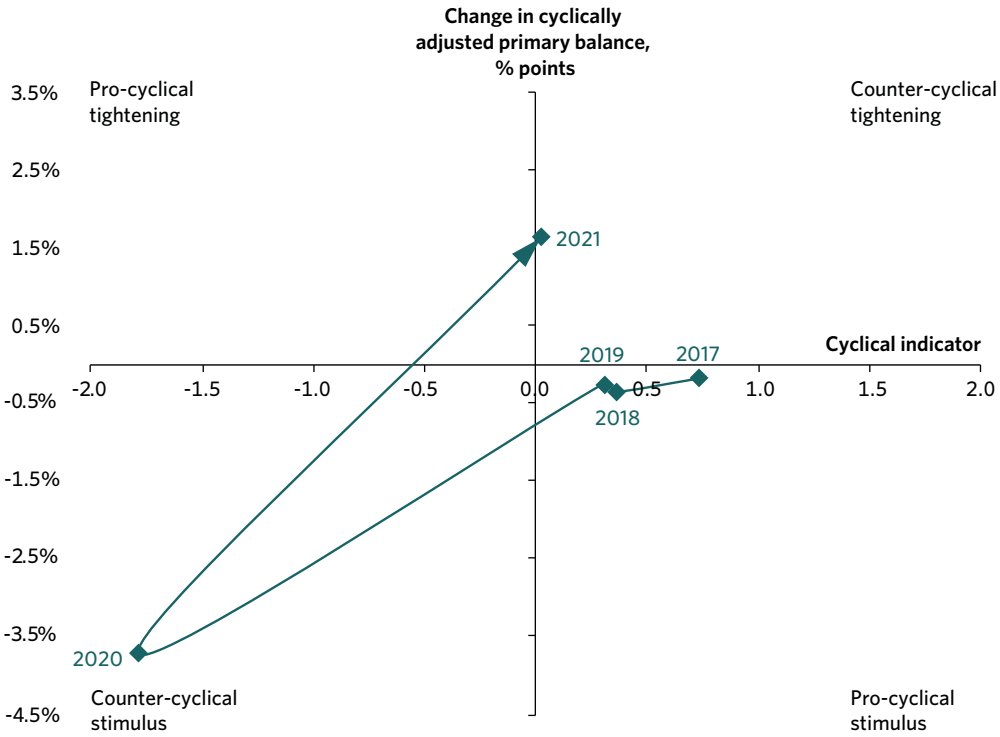

Figure 4: Fiscal policy stance relative to the economic cycle: change in the structural primary balance in relation to the development of the cyclical indicator based on the output gap in 2017–2021. Estimates of cyclical conditions based on the output gap method may change even significantly later on. This may also affect the conclusions about the fiscal policy stance.

A similar conclusion is arrived at when the composite indicator of the heat map is used both in the calculation of the change in the cyclically adjusted primary balance and as the cyclical indicator (Figure 5). The estimate of the fiscal policy stance that is based on the composite indicator corresponds to the estimate based on the output gap, especially in the case of the year 2020.

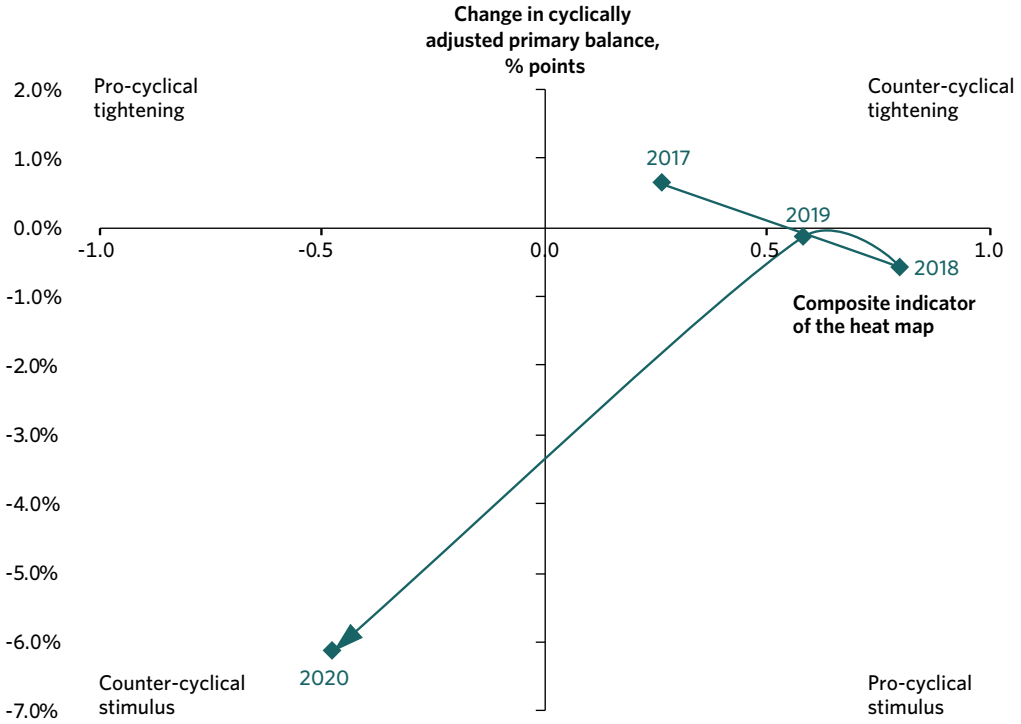

Figure 5: Fiscal policy stance in relation to the economic cycle: change in the structural primary balance in relation to the development of the NAOF's composite indicator in 2017–2020. The composite indicator for 2020 is mainly based on information from the first three quarters. The heat map does not forecast future development, and thus there is no estimate for 2021.

1.2 The Government has reacted to the crisis with its fiscal policy in a timely manner

During the exceptional circumstances that lasted for three months in the spring of 2020, the Government submitted four supplementary budget proposals to Parliament. They increased appropriations to the hospital districts and the Finnish Institute for Health and Welfare for coronavirus-related expenditure and to the police and border surveillance, for example, for the implementation of restrictions. At the same time, both businesses and households were supported so that they would survive the exceptional circumstances. The almost complete lockdown of society drove especially the labour-intensive service sectors to a difficult position, and the number of layoffs grew rapidly. The Government reacted to companies' distress for example by subsidies and loans granted through Business Finland and the Centres for Economic Development, Transport and the Environment

(ELY Centres) and by subsidies to sole entrepreneurs granted through local authorities. In addition, unemployment security was expanded by removing the waiting period, by expediting the layoff procedure, and by including small entrepreneurs in its scope. The period for which the startup grant is paid was also extended. In addition to these discretionary changes to unemployment security, the supplementary budgets allocated more resources to unemployment security expenditure because of the increase in the number of unemployed and laid off people. Furthermore, EUR 700 million was allocated to strengthen the fiscal position of Finnair.

Just before the exceptional circumstances ended, the Government issued a stimulus package included in the fourth supplementary budget proposal. The appropriations included in the stimulus package amount to about EUR 3.6 billion[1]. The National Audit Office estimates that about one billion (27%) of this stimulus is allocated to local authorities and hospital districts. Approximately EUR 840 million (23%) is allocated to labour market benefits and the unemployment benefits of people who have been laid off and thereby to supporting domestic demand.

Approximately EUR 720 million (20%) is intended for supporting enterprises and developing new business. This includes business cost support (EUR 300 million) as well as capital investments in Suomen Malmijalostus Oy (EUR 150 million) and Suomen Teollisuussijoitus Oy (EUR 250 million). Nearly EUR 500 million (14%), in turn, has been reserved for education, research, and young people.

In the supplementary budget proposals of this autumn, the estimates of certain appropriation needs have been adjusted downwards (e.g. as regards compensations paid to local authorities for tax cuts, as well as unemployment security, housing allowance, and social assistance), while appropriations have been increased for example for testing capacity and for planning and implementing vaccinations. The fifth supplementary budget improved the balance of on-budget entities when a smaller amount was paid to local authorities as compensation for the loss of tax revenue as a result of changed tax criteria. This was because the changes made in the spring to the payment arrangements of corporate taxation (reduction in the penalty interest, refund of value-added taxes paid at the beginning of the year, and their inclusion in the tax payment arrangements) had been smaller than expected and had reduced the tax revenue of local authorities less than estimated in the spring.

The sixth supplementary budget increased discretionary government transfers to social and health care units for increasing the testing capacity. The seventh supplementary budget proposal includes, for example, EUR 200 million of discretionary government transfers to social and health care units for Covid-19-related costs and to the Finnish Institute for Health and Welfare for testing capacity and for planning and implementing vaccinations. As for central government transfers to local government basic services, the Government proposes EUR 350 million for testing and tracing costs and EUR 400 million for compensating for other costs caused by the coronavirus pandemic and loss of revenue. Moreover, in relation to the coronavirus situation, the decrease in the proceeds from gambling is compensated for by allocating a total of EUR 330 million to different administrative branches. The Government proposes a total of EUR 111 million for safeguarding the service level of public passenger transport if the coronavirus situation persists. In the seventh supplementary budget, the Government proposes an additional appropriation of EUR 410 million for implementing the second application round for fixed-term business cost support in addition to the unused EUR 140 million of the first round. On the other hand, the appropriation reserved for supporting entrepreneurs in food services is reduced

by EUR 41 million. The authorization granted for supporting business development projects is also proposed to be reduced by EUR 60 million because the amount of subsidies granted has been lower than estimated.

The additional appropriations of the supplementary budgets for 2020 also increase the appropriations of the budget proposal for 2021 by about EUR 1 billion because of multi-annual transport infrastructure projects and the payment of business subsidies, for example. In the budget proposal for 2021, the Government also prepares for direct coronavirus-related costs of about EUR 1.7 billion to be allocated for testing, tracing and treatment, for example. As the economic situation is expected to be weak, the Government proposes the allocation of about EUR 0.8 billion more than in the regular budget for cyclical expenditure, i.e. pay security, housing allowance, social assistance, and the state's share of unemployment security expenditure. Central government transfers to local government basic public services are increased by EUR 0.3 billion to compensate for the decrease in tax revenue following the weak economic situation.

Due to the coronavirus epidemic and the uncertain economic situation, EUR 500 million have been reserved in the budget proposal for 2021 for one-off expenses and coronavirus-related expenditure that is fiscal-politically obligatory in such a manner that the amount cannot be used for other expenditure. Furthermore, a mechanism for exceptional circumstances has been activated for 2021 in the spending limits rule for one-off expenses. The mechanism increases the spending limits for 2021 by EUR 500 million.

Overall, fiscal policy has reacted to the economic impacts of the corona crisis in a timely manner in relation to the labour market development (Figure 6). Both businesses and households were supported by discretionary fiscal policy in the spring as soon as the restrictions and recommendations closed our society. The actual stimulus was launched in the summer of 2020 once the most drastic restrictions had been lifted. During the autumn, the estimated appropriation needs have been adjusted based on the actual figures, and testing capacity has been increased in order to keep society open. The economic stimulus is continued in the budget proposal for 2021, although in a more subdued form than in 2020. It is justified to continue a fiscal policy that supports economic growth in 2021, as the epidemic will continue to have an impact on the economy in 2021

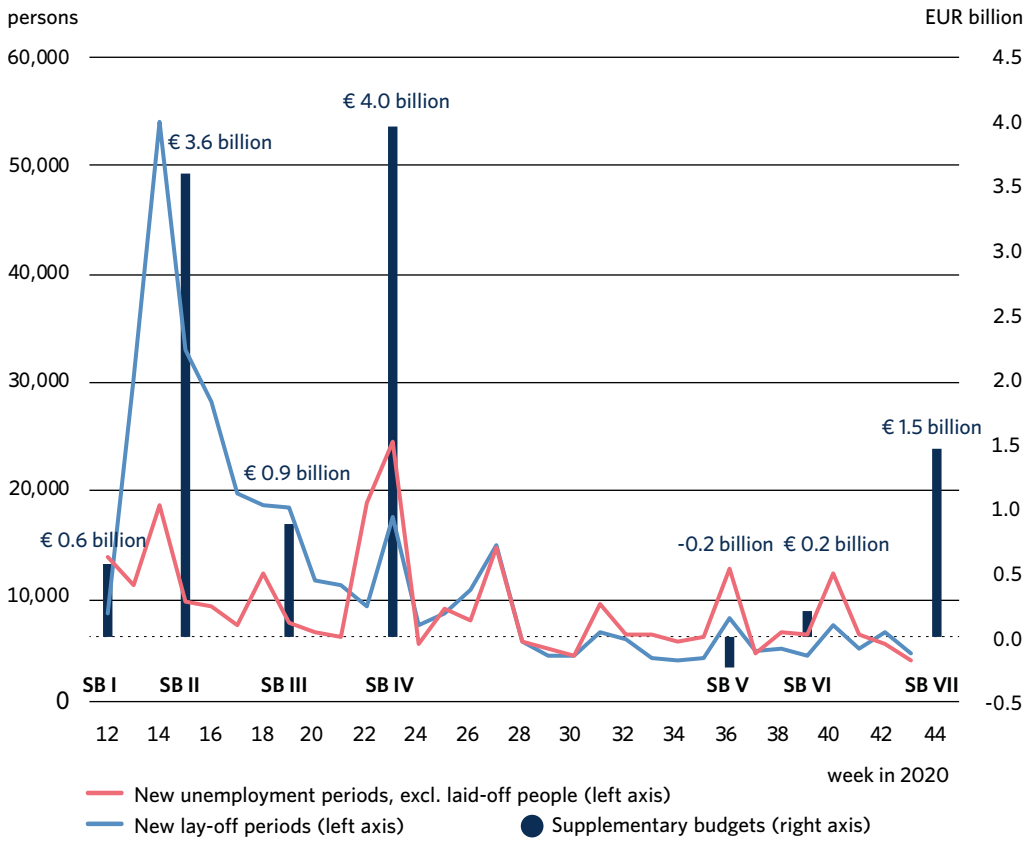

Figure 6: Appropriations under supplementary budgets and new unemployment and lay-off periods. Source: MoF and Employment Service Statistics.

So far, business subsidies have been used slightly less than budgeted (Figure 7). There are many possible reasons for this. Companies' situation did not become as difficult in the spring as feared – partly because of the post-cyclical nature of the Finnish economy. Order backlogs continued to provide employment in export industries during the spring. Moreover, domestic demand recovered quickly from the collapse in the spring (e.g. purchases made by Nordea's customers in June 2020 using their cards exceeded the amount of purchases in June 2019).

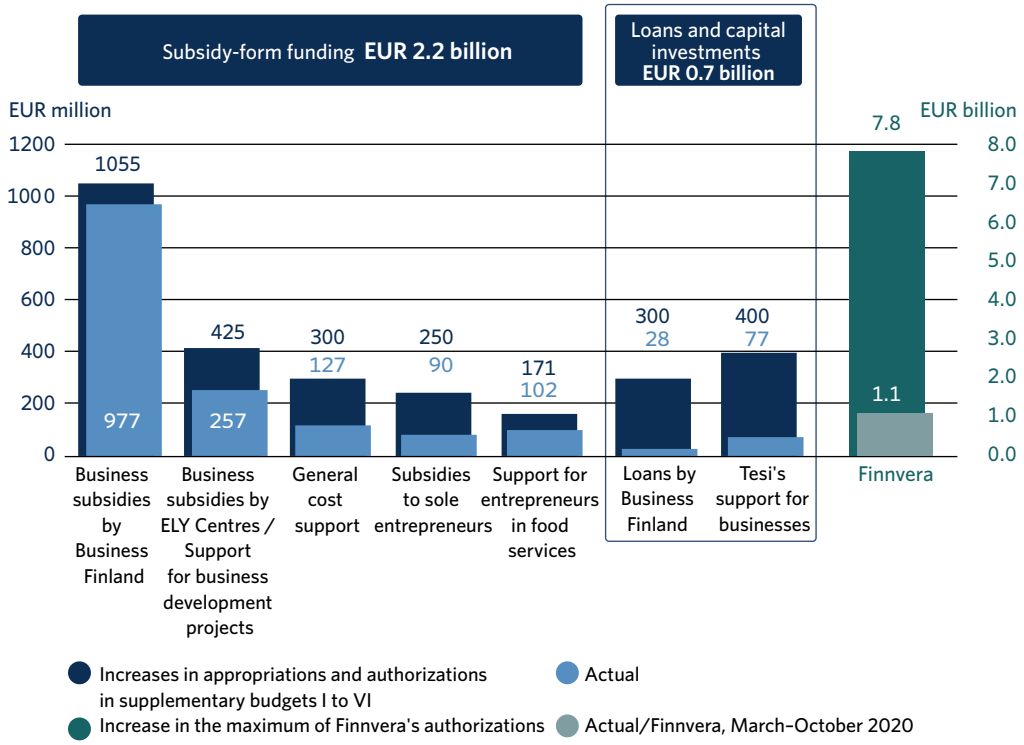

Figure 7: Government support for businesses in the coronavirus situation and the actual amounts.[2] Source: Tutkihallintoa.fi, State Treasury, Business Finland, Ministry of Economic Affairs and Employment, Development and Administrative Centre for the ELY Centres and TE Offices (KEHA Centre), Finnish Industry Investment Ltd (Tesi), and Finnvera.

The number of applicants for business cost support has been considerably smaller than estimated when the law was drafted, and thus the total amount of support granted has remained smaller than estimated.[3] Of the EUR 300 million reserved for cost support, companies were paid EUR 127 million. The use of the discretionary subsidy of EUR 2,000 to sole entrepreneurs has also remained slightly lower than expected: of the EUR 250 million reserved for the subsidies, EUR 95 million will be used according to the estimate of the Ministry of Economic Affairs and Employment. According to Parliament, a prerequisite for the partial closure of restaurants[4] in the spring was compensation for their loss of income[5]. The Government reserved EUR 171 million for compensations for loss of income and for support for re-employment.[6] The KEHA Centre forecasts that the amount of support paid will remain at about EUR 123 million.[7] This is because the taxable sales of restaurants did not fall by 75% during the period of restrictions compared with the reference months thanks to takeaway sales, for example. The number of applications has also been slightly smaller than expected. In relation to the increases of EUR 400 million granted in the supplementary budgets, Tesi has made investment decisions for a total of EUR 76.8 million. A smaller number of applications than expected have also been filed as part of the relieved payment arrangements for the refund of value-added taxes already paid. The Finnish Tax Administration has refunded a total of EUR 393 million of value-added taxes in relation to the relieved payment arrangements, while in the legislative proposal, the refunds were estimated to amount to about EUR 515 million.

The good availability of open-market financing and the possibility of grace periods can explain the low demand for Finnvera's funding, in particular. In March, the maximum amount of Finnvera Oyj's domestic funding (guarantees and loans) was raised from EUR 4.2 billion to EUR 12 billion as an off-budget measure. The increase was mainly intended to be used for guaranteeing credits granted by banks. The additional funding was estimated to be targeted mainly at SMEs. At the same time, however, the limit previously applied to Finnvera's credit and guarantee loss obligation, according to which Finnvera was allowed to grant financing to large corporations for up to EUR 420 million, was temporarily cancelled until the end of 2020. In addition, the amount of compensations paid by central government to Finnvera for credit and guarantee losses was raised from 50 to 80 per cent. The impacts of the increase in the compensations for losses, in the financing volume and in the compensation percentage for credit and guarantee losses on the on-budget entities were taken into account in the General Government Fiscal Plan of spring 2020, where the estimated expenditure for compensation for losses was increased by a total of EUR 613 million for 2021–2024. The financing granted by Finnvera between March and October amounts to EUR 1.1 billion. Although the amount of financing granted falls clearly below the maximum amount possible after the increase, the financing needs of SMEs and mid-caps have grown in 2020 from 2019. The domestic financing granted by Finnvera from January to October 2020 is more than 90 per cent higher than in the corresponding period of 2019. However, the good availability of open-market financing and the possibility of grace periods have partly limited the need for new financing by Finnvera.

As the Finnish economy is post-cyclical in nature, the need for financial support may grow in the autumn of 2020 compared with the spring. According to Statistics Finland, the value of new orders for industry was 17.3 per cent lower in August 2020 than the year before. According to the preliminary statistics of the Finnish Customs, the value of goods exports fell by 14.8 per cent in August 2020 from the year before. For this reason, the total wage bill within industry, construction, support services and logistics has been lower in August 2020 than in August 2019.[8]

The number of bankruptcies has fallen in 2020 from the previous year. However, this is partly due to a temporary change made to the Bankruptcy Act (292/2020) which considerably restricted creditors' right to apply for corporate bankruptcy of a debtor company. The temporary change is valid until the end of 2020. The trend in the number of bankruptcies from 2021 onwards will show how well companies have survived the decline in demand.

The unemployment rate is far from the level of the 1990s recession – the economic impacts have so far been more limited than in Sweden

The number of laid-off people has increased more during the coronavirus crisis than during the financial crisis (Figure 8). However, the unemployment rate is still far from that of the recession in the 1990s. The situation in the labour market may weaken again during the autumn.

> During economic downturns, the employment of young adults falls typically more than that of the older age groups as companies recruit less people.

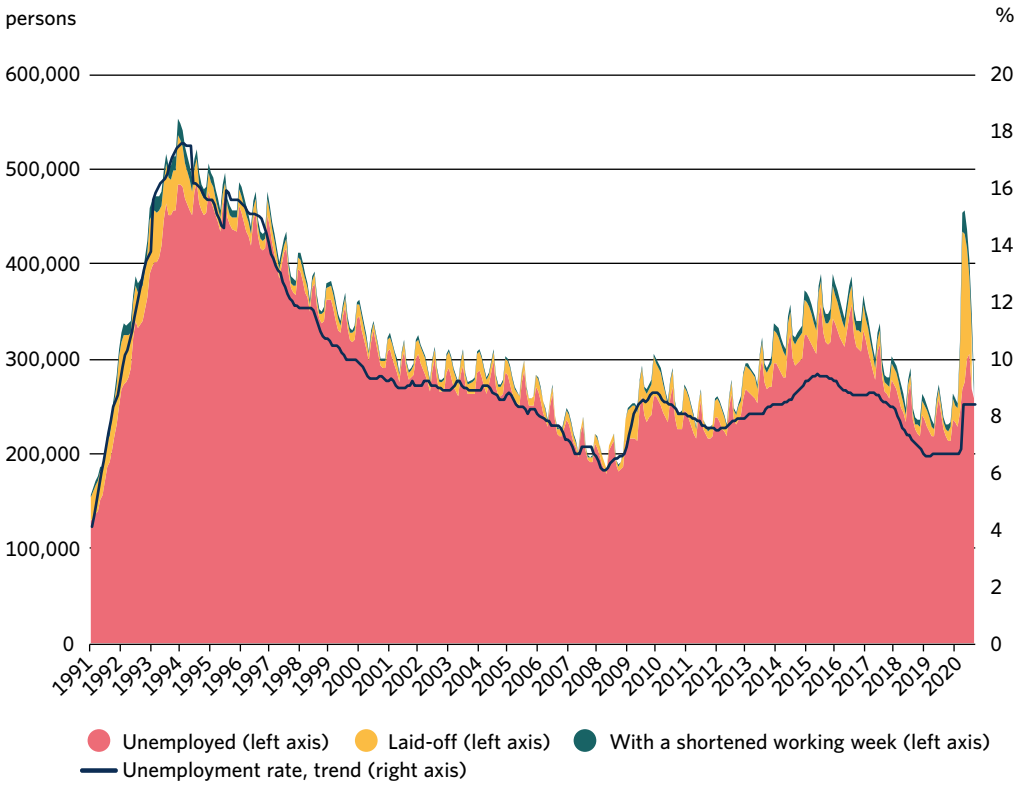

Figure 8: Laid-off and unemployed people and bankruptcies 1990–2020[9]. Source: Employment Service Statistics and Statistics Finland.

The impacts of the corona crisis on the labour market hit young adults in particular. The wage bill of young people under 25 has decreased the most during the past year. Young adults have also applied for Kela's unemployment benefit the most. However, this is because many young people do not meet the previous employment requirement, which is the condition for earnings-related unemployment allowance, or are not members of unemployment funds.[10] The employment rate and income declined more among young people than in the other age groups even during the 1990s recession, and the disposable income of young people has developed slightly more slowly than that of the older age groups after the recession as well. [11]

Domestic demand can be supported during the crisis by economic stimulus based on fiscal policy and by managing the epidemic and keeping society open. This makes it possible to mitigate the detrimental long-term impacts of the crisis on the Finnish economy, while supporting the sustainability of general government finances in the longer term. In

2020, Finland has succeeded better than Sweden in the management of the pandemic situation (Figure 9). The labour market and the economy have also developed more favourably in Finland than in Sweden. In Sweden, GDP contracted by as much as 8.8% in the second quarter of 2020, whereas in Finland it fell by 4.4%.[12] The sharp decrease in GDP in Sweden resulted from the decline in net exports (the difference between exports and imports). Although exports fell in Finland as well in the second quarter, imports fell even more, turning net exports from negative to positive. Private consumption declined equally in both countries. Based on the available information, discretionary stimulus measures have amounted to 11.8% of GDP in Sweden and 7% of GDP in Finland.[13] Both countries have had similar volumes of guarantees and loans.

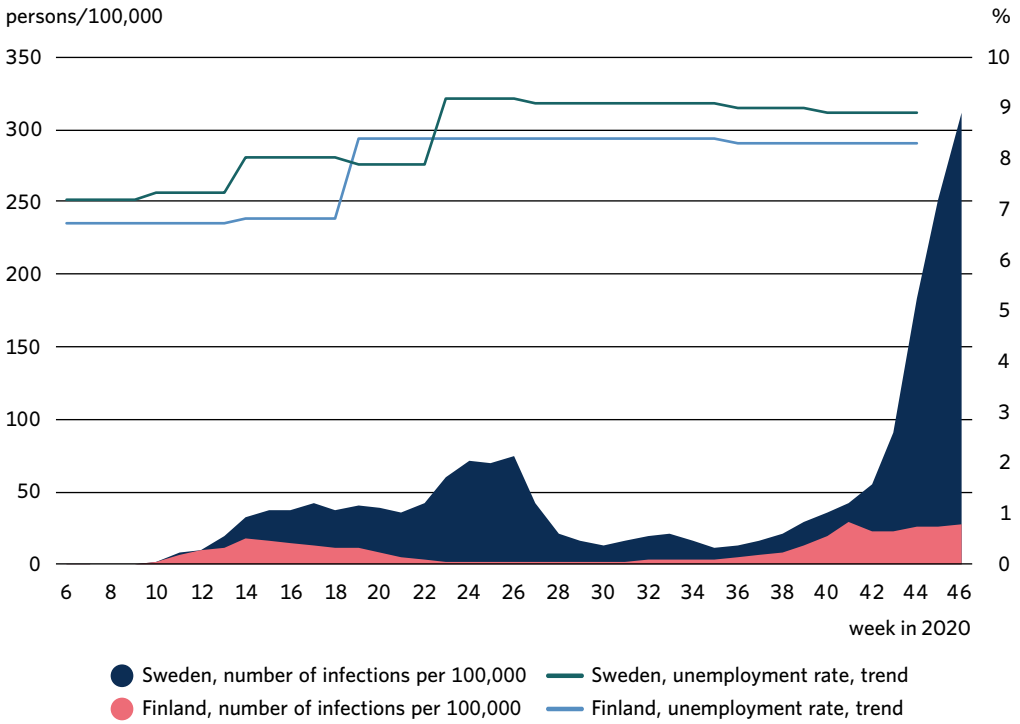

Figure 9: Number of infections (per 100,000 people), and unemployment rate in Finland and Sweden. Source: Statistics Finland, Finnish Institute for Health and Welfare, Public Health Agency of Sweden, Statistics Sweden, and ECDC.

1.3 After many exceptions it is necessary to return to the parliamentary-term spending limits

The present spending limits system has been valid since 2004 (Figure 10). The Government sets four-year spending limits, i.e. a cap on budget expenditure, at the beginning of the parliamentary term. About 75 per cent of budget expenditure falls within the scope of the spending limits, which is about 35 per cent of the entire general government

expenditure. The purpose of the spending limits rule is to limit the total amount of expenditure borne by taxpayers. If changes that are neutral from this perspective are made to the budget, similar adjustments can be made to the spending limits of the parliamentary term.

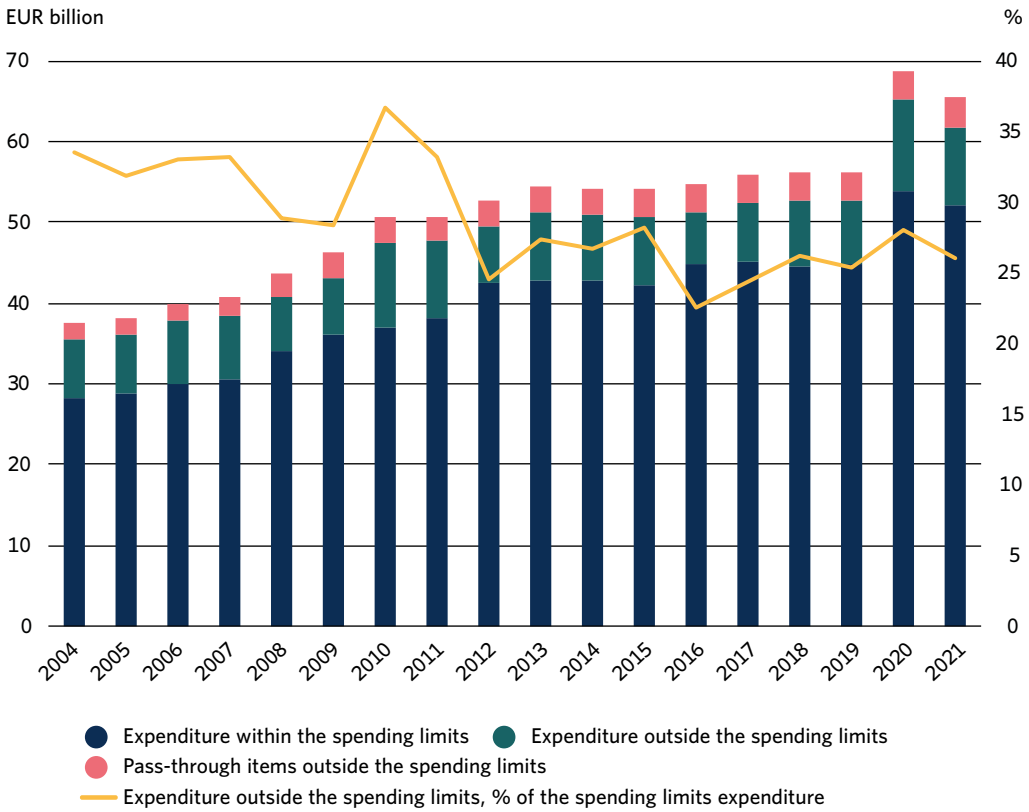

Figure 10: Expenditure within and outside the spending limits 2004-2021. Source: Budget information and MoF.

The Government's decision to dispense with compliance with the spending limits for 2020 was justified under the exceptional circumstances. The setting of spending limits and thus also dispensing with them are political decisions that fall within the powers of the Government. The formulation of the Government's decision may have given the impression that dispensing with the spending limits would be a direct consequence of the introduction of the Emergency Powers Act. However, the Emergency Powers Act does not contain provisions about the spending limits rule. The introduction of the Act does not necessarily require dispensing with the spending limits even though it is likely that the circumstances that have led to the introduction of the Act will cause unexpected expenditure. The spending limits rule does not specify cases where it would be justified to dispense with the rule.

The credibility of the spending limits rule is entirely dependent on political commitment. During the present spending limits system, from 2004 to 2019, all Governments have achieved the spending limits objectives they have set. During its existence, the spending

limits system has been supplemented with mechanisms that increase its flexibility so that unexpected additional expenditure arising during government terms could be processed within the scope of the spending limits rule. The latest example of such additions is the mechanism for exceptional circumstances added to the spending limits rule of the ongoing parliamentary term to enable the Government to react to the stimulus need resulting from a severe recession.

It is also possible to dispense with the spending limits rule completely, and this was done for the first time in 2020. This option should also be considered when it is assessed whether the spending limits rule is sufficiently flexible to function in different situations. The spending limits rule is not even intended to function in all circumstances. The rule should be inflexible in certain respects in order to limit the growth of expenditure. Although it is possible to dispense with the spending limits rule, the threshold for doing this should be very high. The Government seems to have the ambition to adhere to the rule from 2021 onwards. The Government justified dispensing with the spending limits in 2020 by the introduction of the Emergency Powers Act, which is a clear indication of exceptional circumstances. Nevertheless, it is important to return to compliance with the spending limits rule from 2021 onwards in order for the rule to remain a credible instrument for limiting the growth of expenditure and to restore the political commitment that it is built upon.

In the budget for 2021, the expenditure level has been changed within the flexibility provided by the spending limits rule, but flexibility has also been sought through exceptions to the spending limits rule. The spending limits were raised in compliance with the rule by EUR 500 million as enabled by the mechanism for exceptional circumstances. The amount was allocated to increases in one-off expenses. This was the first time that the mechanism for exceptional circumstances was activated. It will now be important to obtain information on how the mechanism serves as part of the spending limits rule. When it is assessed how the mechanism achieves the objectives set for it, the key factors will be the timing of the stimulus enabled by the mechanism and the selected items of expenditure. It would be important to monitor which additional expenses in the budget correspond to the additional one-off expenses enabled by the mechanism.

As an exception to the spending limits principle, an additional reserve of EUR 500 million has been entered in the budget for 2021 for coronavirus-related one-off expenses that are necessitated by fiscal policy. Moreover, in the budget for 2021, coronavirus-related direct costs were entered outside the spending limits, and thus the spending limits do not apply to them. (Direct costs include expenses caused by testing, tracing, quarantine, treatment of patients, vaccination, and travel-related health security.) These costs were estimated to amount to EUR 1.660 billion. This exception to the spending limits rule can be considered appropriate to guarantee the direct additional expenses required by the management of the corona crisis. In the budget for 2020, some appropriations for supporting businesses and for compensations for losses from financing authorizations were transferred outside the spending limits – from 2021 onwards as a conscious exception to the spending limits rule.

Because of the exceptionally high number and large scope of the exceptions made for 2021, the return to the spending limits of the parliamentary term does not seem to be fully successful. Generally speaking, however, returning to the spending limits procedure limits the growth of expenditure better than no spending limits at all. The spending limits rule can be changed in the middle of a government term by a political decision. However,

there is the risk that such changes erode the credibility of the Government's commitment to the spending limits for the entire government term. The spending limits rule does not limit the growth of total expenditure if it is possible to increase unexpected expenses both within and outside the spending limits during the government term. The credibility of the system is weakened if it is possible to avoid breaking the spending limit by violating the spending limits principles.

If the spending limits had been in force in 2020, they would have been exceeded by EUR 8.4 billion

The National Audit Office has monitored how the spending limits for the parliamentary term 2020–2023 were calculated from the technical spending limits of the parliamentary term to the actual budget proposal for 2021. Figure 11 below illustrates the four-year spending limits at the four different preparatory phases: as technical spending limits, as spending limits of the Government Programme, as spending limits of the General Government Fiscal Plan for 2021–2024, and at the time of the budget proposal for 2021. Finally, the figure shows the expenditure included in the scope of the spending limits. According to the calculations of the National Audit Office, the expenditure exceeded the spending limits by EUR 8.4 billion in 2020. Because of the coronavirus pandemic, the spending limits for 2020 have not been valid from the first supplementary budget onwards.

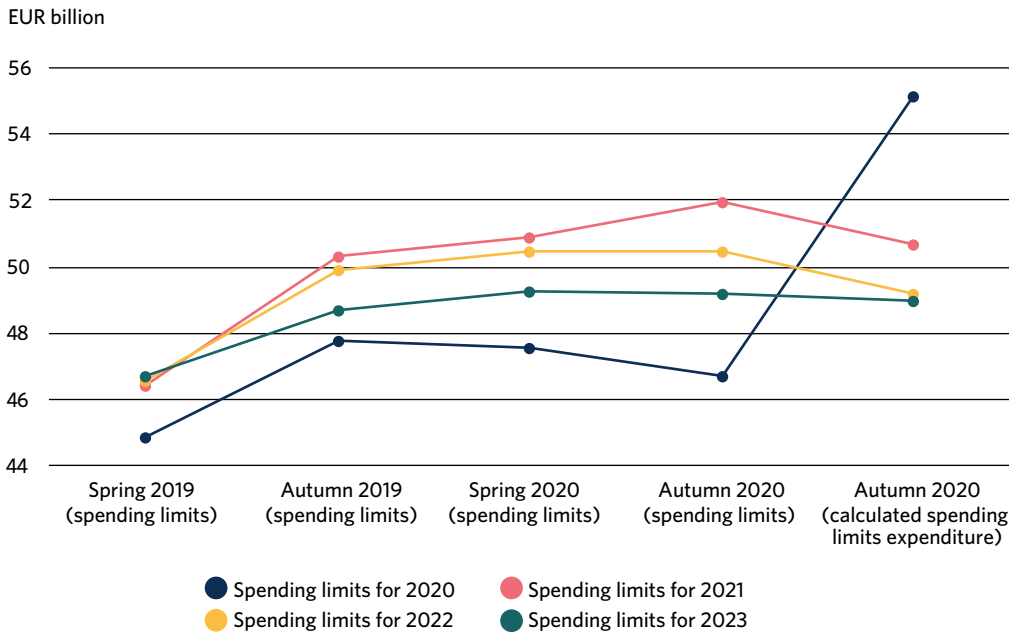

Figure 11: Preparatory phases of the spending limits for the parliamentary term 2020–2023. Source: General Government Fiscal Plans, actual budget proposal for 2021, seventh supplementary budget for 2020, adjustments to spending limits after General Government Fiscal Plan for 2021–2024, and calculations by the NAOF.

Although the spending limits for 2020 were not in force during the preparation of the supplementary budgets, they were adjusted at the time to tighten them by EUR 1.3 billion. The most significant adjustments tightening the spending limits resulted from the changes made to the grounds for appropriations outside the spending limits and from the economic stimulus.

When the budget proposal for 2021 was prepared, the spending limits for 2021 were relaxed by EUR 500 million by introducing a new reserve within the spending limits for coronavirus-related expenses (Figure 12). As a result of the introduction of the new reserve, the margin of manoeuvre provided by the spending limits for 2021 grew almost back to its original level, i.e. EUR 1.3 billion, although it had contracted by EUR 511 million to EUR 779 million during the previous preparatory phases of the spending limits.

During the previous parliamentary terms, compliance with the spending limits has meant agreeing on the margin of manoeuvre provided by the spending limits in the first spending limits decision of the Government and ensuring that the additional expenses during the parliamentary term do not exceed this margin. Making a discretionary increase in the overall spending limits in the middle of the parliamentary term is not in compliance with the spending limits rule. On the other hand, the state's economic situation has been exceptional during the ongoing parliamentary term. It is important for the sustainability of central government finances that the Government pays attention to the development of central government expenditure and strives to curb its growth.

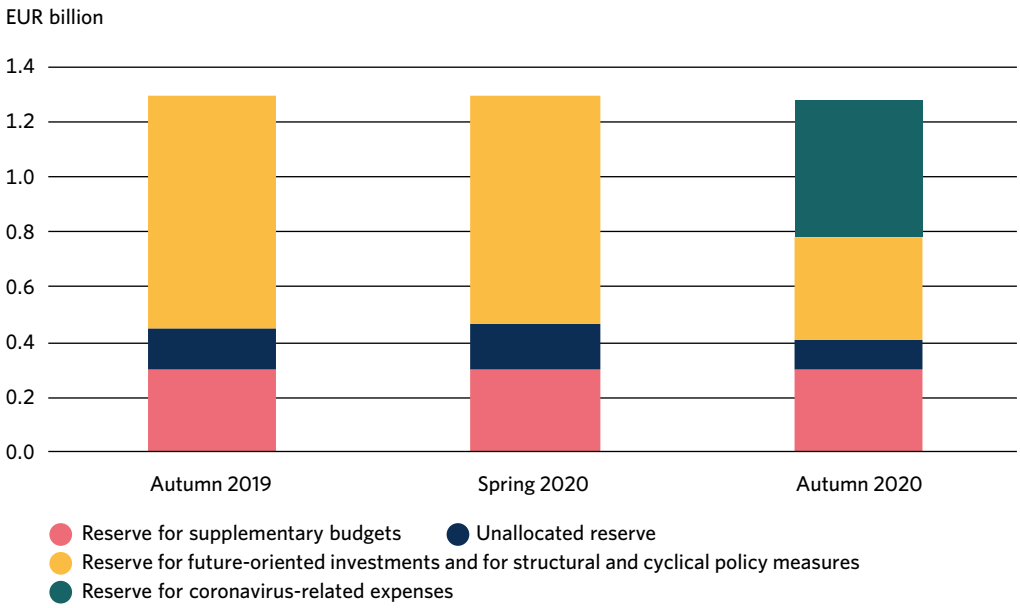

Figure 12: Margin of manoeuvre provided by the spending limits for 2021 in the Government Programme, the General Government Fiscal Plan for 2021–2024, and the actual budget proposal for 2021. Source: General Government Fiscal Plans, budget proposal for 2021, and calculations by the NAOF.

The new business subsidies in 2020 have resulted in new appropriation needs for the following years, but unlike before, these additional appropriations have been entered outside the spending limits in the budget.

Taking coronavirus-related changes in expenditure into account in the spending limits for the coming years, while striving to adhere to the spending limits for the parliamentary term set out in the Government Programme, has led to such solutions in the spending limits calculations that are not in compliance with the previous spending limits principles. However, even adjusted principles can curb the growth of expenditure even.

Expenditure outside the spending limits for 2020 has grown rapidly

Since 2004, budget expenditure has been divided into expenditure within the spending limits and expenditure outside them. Expenditure outside the spending limits includes cyclical expenditure, such as allowances related to the unemployment situation and social security. In addition, expenditure outside the spending limits includes central government debt interest payments, compensation to local authorities for tax cuts, and financial investments (Figure 13). Some of the expenditure items outside the spending limits are different types of pass-through items, which means that the budget has revenue to offset the expenditure in question. Although the spending limits rule is not in force in 2020, it is still possible to monitor the development of spending limits expenditure and expenditure outside the spending limits. The changes to the spending limits rule that will enter into force in 2021 have already been included in the assessment of this report. The spending limits do not apply to expenditure budgeted outside them. Thus, its level could have changed even if the spending limits rule had not been dispensed with.

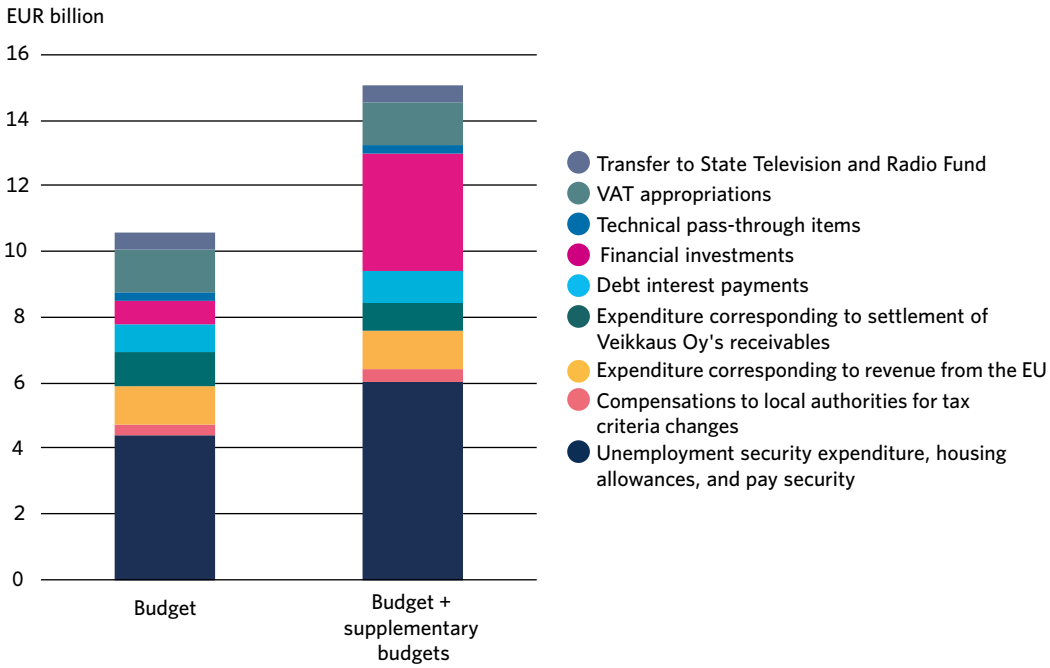

Figure 13: Changes in expenditure items outside the spending limits in relation to the budget for 2020 after the supplementary budgets. Source: Budget information and MoF.

In 2020, expenditure outside the spending limits has grown by EUR 4.3 billion compared with what was originally estimated in the budget. Financial investments have grown the most: the amount budgeted outside the spending limits is EUR 2.8 billion higher than in the budget. The investments and support are mainly related to the management of the economic crisis caused by the coronavirus epidemic. The second place is held by cyclical unemployment security expenses, housing allowance, and pay security, totalling EUR 1.5 billion. These cyclical expenses serve as automatic stabilizers. Thus, their growth indicates that they function as intended. Estimated interest payments (EUR 38 million) have slightly grown along with increased net borrowing. Other estimated expenditure outside the spending limits has remained unchanged.

As the amount of Veikkaus Oy's receivables has decreased, part of the expenditure corresponding to their settlement has been transferred to the scope of the spending limits from 2020 onwards. A decision was made to compensate for the financing of Veikkaus Oy's beneficiaries in such a manner that the financing corresponds to the 2019 level of receivables even in 2020 and 2021. The compensation amounts to about EUR 176 million in 2020 and to about EUR 347 million in 2021. The decrease in Veikkaus Oy's proceeds is mainly due to measures taken to reduce the negative impacts of gambling and to the reduction of its market share. Therefore, the level of the proceeds is not likely to return to the level of 2019 in the near future. It has been justified to budget gambling proceeds outside the spending limits, as they can be considered a pass-through item: the budget has allocated revenue to offset the expenditure in question. If the Government is committed to maintaining the funding of gambling beneficiaries' operations at the present level regardless of the amount of Veikkaus Oy's proceeds, the appropriations allocated to this should rather be budgeted in full within the spending limits.

1.4 Both statutory and political economic objectives have justifiably provided flexibility during the corona crisis

The Government has political objectives that are included in the Government Programme and relate to public finances and the national economy. It also has statutory objectives that are included in the General Government Fiscal Plan and relate to public finances.[14] According to the Government's fiscal policy objectives set out in its Government Programme, the employment rate should be raised to 75 per cent and general government finances should be in balance in 2023. The Government Programme states that these objectives are valid in normal international economic circumstances.

In its previous assessments, the National Audit Office has considered it useful to link the objectives set out in the Government Programme to the international economic situation, which has proved to be necessary because of the corona crisis. In spring 2020, the Government assessed justifiably that the international economy could not be considered to be in a normal situation. Although the duration of the corona crisis is not yet known, the crisis will in any case cause such a severe shock in the global economy that, based on present information, the international economic circumstances will be abnormal in 2019–2023.

> The General Government Fiscal Plan of spring 2020 did not include fiscal policy objectives.

The decisions made in Finland are line with the EU's decision – the EU decided to allow deviations from fiscal policy objectives

On 20 March 2020, the Commission issued a communication on the activation of the general escape clause of the Stability and Growth Pact concerning both the preventive arm (the Member States should either achieve their medium-term objectives for the structural fiscal position or be heading towards them; in Finland the objective is at present –0.5 per cent of GDP) and the corrective arm (the reference value of government deficit is 3 per cent of GDP; the reference value of government debt is 60 per cent of GDP). The activation of the escape clause means that the Member States are allowed to deviate from the objectives set for general government finances. The aim of the activation of the clause is to ensure that the EU rules steering general government finances do not restrict the management of the corona crisis or the economic stimulus measures. On 23 March 2020, the EU Ministers of Finance announced their support for the activation of the escape clause.

The Government submitted its latest General Government Fiscal Plan to Parliament on 16 April 2020. The flexibility provided by fiscal policy legislation was utilized in the plan. The General Government Fiscal Plan for 2021–2024 was issued under exceptional circumstances, and it lacked a large part of the information content required under the Decree on the General Government Fiscal Plan. The Plan did not include the objectives set by the Government for the general government fiscal position (net lending, i.e. surplus or deficit), public spending, and government debt. Nor did it therefore describe the Government's plans for achieving these objectives.

The Decree on the General Government Fiscal Plan contains one provision related to exceptional circumstances. According to it, the requirements concerning the setting of nominal fiscal position objectives are less strict when the EU Council has declared that exceptional circumstances are prevailing in Finland. However, it should be noted that the aim of the provision has actually been to provide flexibility to the tightness of objectives and not to make it possible to set no objectives at all.[15] Based on its original purpose, the provision on exceptional circumstances in the decree is not directly applicable to the exceptional situation of spring 2020, where no objectives at all were set.

For the assessment of compliance with domestic legislation, it is essential that the Fiscal Compact concluded between the Member States and the Budgetary Frameworks Directive issued by the Council of the European Union are implemented in Finland through the Fiscal Policy Act and the Decree on the General Government Fiscal Plan. The aim is to support the rules set by these EU instruments on national level particularly by multi-annual planning. During the spring of 2020, EU regulation justifiably allowed temporary deviations from the adjustment path leading to the medium-term objective and eased the content requirements set for the Stability Programme to be submitted to the EU.

In the exceptional situation caused by the corona crisis, it is logical that the role of the domestic legislation created to promote compliance with the EU rules is also assessed based on how the underlying EU rules are interpreted. Therefore, it is justified to interpret that the flexibility provided by the EU procedures is also included in national requirements.

It should also be noted that a key element in the Fiscal Policy Act is the correction mechanism to be activated if there is a significant deviation from the objective set for structural balance. As deviations from the objective are allowed under the general escape clause, failure to comply with the target set for structural balance could not, in practice, lead to the activation of the correction mechanism for the time being. The Decree on the General Government Fiscal Plan, in turn, links the level of nominal fiscal position objectives with the structural balance objective in such a manner that they must lead to the achievement of the structural balance objective. In view of the correction mechanism, objectives related to nominal fiscal position are therefore unnecessary for the time being, as setting or achieving them would not have any effect on the activation of the mechanism.

On the above grounds, the National Audit Office considers that the General Government Fiscal Plan for 2021–2024 issued by the Government in spring 2020 complied with the contents of fiscal policy legislation, taking into account the prevailing exceptional circumstances. In the future, the legislation should nevertheless be specified to include more clearly formulated provisions on exceptional circumstances similar to the present ones.

In addition, the Government should return to normal planning of general government finances and target setting as soon as possible. After the crisis, it is important to steer general government finances to the path towards the budgetary balance objective. This requires systematic planning and commitment to medium-term financial planning. It should be noted that fiscal policy legislation also makes it possible to set less strict objectives for general government finances in an exceptional economic situation. Even if the objectives set for the nominal fiscal position do not lead to achieving the objective set for the structural fiscal position, they are an important starting point for the planning of public finances and promote balanced general government finances.

2 The government debt-to-GDP ratio should be stabilized

The government debt-to-GDP ratio will increase considerably in Finland because of the corona crisis. However, compared with other EU countries, it will remain close to the EU average. The additional loans that the State of Finland has taken in 2020 have been at zero interest in practice, and the low interest rates support general government's ability to manage the growing debt. However, the low interest rates may erode the sustainability of the funding of the earnings-related pension scheme. In addition, central government contingent liabilities, such as state guarantees, have grown, while at the same time, the risks involved in some of the state guarantees have increased because the crisis has aggravated the situation in the cruise industry. Additional liabilities also result from EU-level measures related to the coronavirus crisis.

The Government's objective to stabilize the government debt-to-GDP ratio by 2030 is justified. The costs of refinancing loans maturing in the future involve a risk. Thus, the management of general government finances should not rely on the assumption that the interest rates will remain low permanently. Stabilizing the debt-to-GDP ratio is also justified because in Finland, the ageing population causes risks to the development of expenditure. Under the current, uncertain circumstances, it is also justified to refrain from setting an actual numeric ceiling or objective for the government debt-to-GDP ratio.

The sustainability roadmap, on which the Government agreed in 2020, offers starting points for improving sustainability. However, the measures included in the roadmap and the assessment of their impacts on general government finances should be specified. The roadmap should also prepare for the uncertainty included in different debt scenarios. This means that the roadmap should present sensitivity analyses of how much public finances should be strengthened in order for the debt-to-GDP ratio to be stabilized. In addition, the roadmap should in advance define how to operate in situations where the amount of required adjustment changes.

2.1 Low interest-rates support debt sustainability, but contingent liabilities form an increasing risk

Finland's government debt is expected to grow rapidly as a result of the corona crisis. According to the forecasts by the Ministry of Finance and the Commission, government debt will grow to 70 per cent of GDP in 2020. Government debt is also expected to continue growing, although at a more moderate rate. In European benchmarking, Finland's debt-to-GDP ratio is close to the average level based on both the mean and the median. When Finland's debt ratio is compared with the total debt ratio of the European countries, Finland's debt level remains below that of the EU and the euro area. Finland's

> The government debt-to-GDP ratio in Finland will continue to be lower than the total debt ratio of the euro area even after the crisis.

growing indebtedness in 2020 and 2021 is expected to hardly change Finland's position compared with the EU Member States or the euro-area countries, as the other countries' indebtedness is also growing rapidly as a result of the corona crisis. The rapidly increasing indebtedness of large economies, such as France and Italy, has a significant impact on the development of the total debt ratio of the EU and the euro area (Figure 14).

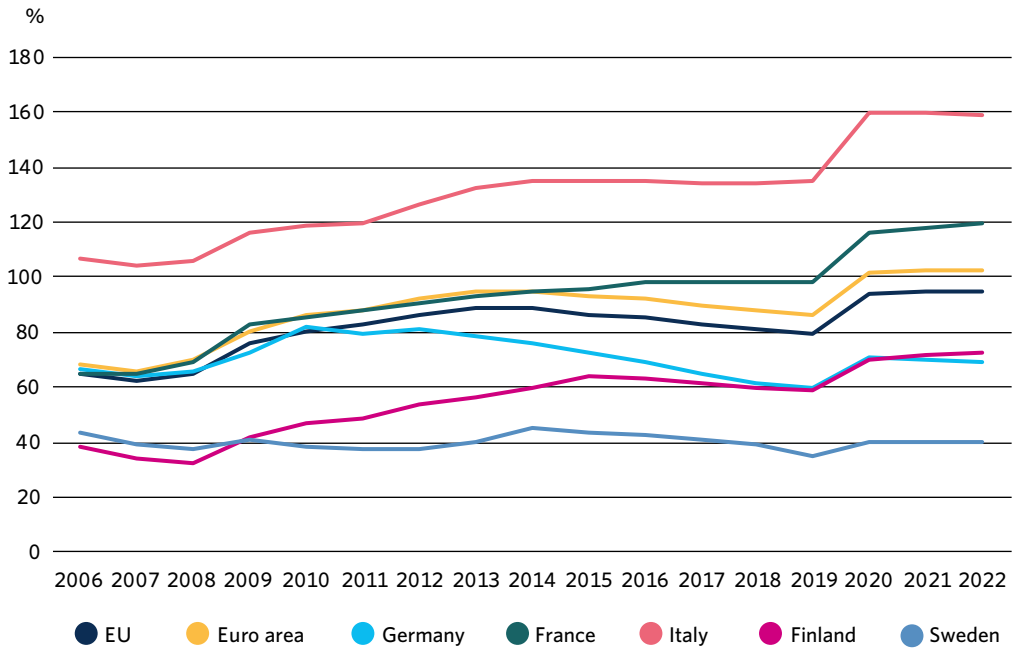

Figure 14: Government debt-to-GDP ratio in certain countries. Source: EU Commission.

In the current market situation, the rapid growth of Finland's public debt will not significantly burden general government finances in the near future. At present, the market interest rate on the ten-year bond of the State of Finland is negative (Figure 15). The outbreak of the corona crisis increased the interest rate at first, but the monetary measures taken by the ECB eased the upward pressure on the interest rate. The interest rate differential of government bonds vis-à-vis Germany increased somewhat during the crisis but has later returned to the pre-crisis level. Finland still pays no significant risk premium for its borrowing unlike for instance Italy, where the interest rate on government bonds has deviated from that of the most risk-free euro-area countries since the financial crisis.

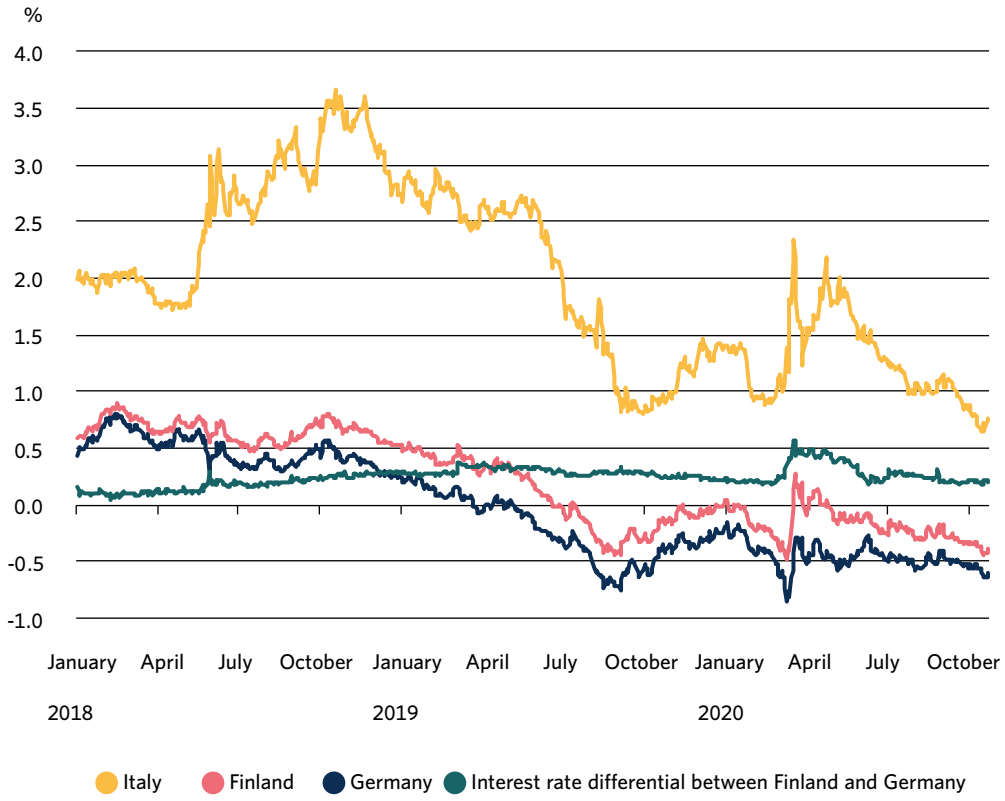

Figure 15: The market interest rate on the 10-year government bond of Finland, Germany and Italy, and the interest rate differential between Finland and Germany. Source: Macrobond and NAOF.

At the same time, the interest rates on even longer-term government bonds in Finland are very low. The interest rate on a bond maturing in 2042, for example, was −0.1 per cent at the end of 2020. The long-term interest rates on Finland's government bonds have been low for a long time, and in the recent years, they have fallen further. As a result of this, the yield curve of Finland's government debt, which illustrates the dependence of government debt interest rates on the maturity of the bond, has flattened during the past few years from its already low level (Figure 16). Yield curves cannot be interpreted in a straightforward manner, as in addition to interest rate expectations, they are also subject to several other factors. Therefore, it is not possible to forecast the future interest rate, for example, directly on the basis of yield curves. However, the present yield curve and the changes in it during the past few years do not indicate that the market expects the interest rate to increase essentially and rapidly..

Even 20-year bonds are now at zero interest.

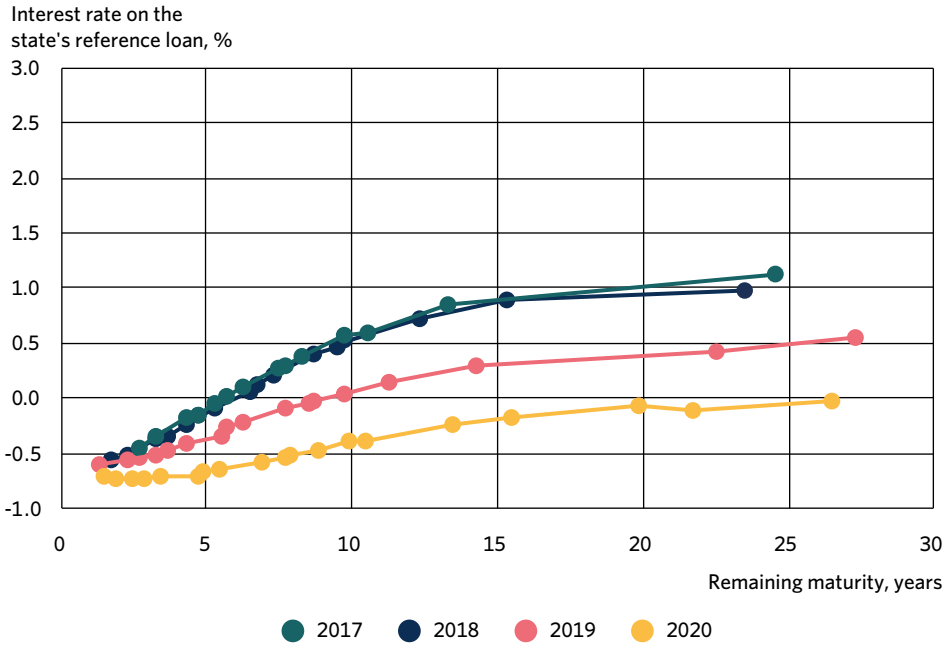

Figure 16: Market interest rates on Finland's reference loans according to their remaining maturity at the end of 2017, 2018 and 2019, and at the end of October 2020. Source: Bank of Finland and NAOF.

Yield curves indicate market expectations

A yield curve is a graphic illustration of the time structure of interest rates, i.e. of how the yield of a bond depends on the maturity of the bond. The curves have typically been rising, which indicates that investors require investments of long maturities to provide a higher yield than those of short maturities. The flattening (falling) of a yield curve may indicate that investors no longer require a long-term bond to provide as high a yield as before. Investors then no longer require as high a yield buffer against rising inflation as before, or they require a smaller risk or liquidity premium for their investment. Thus, the flattening of the curve usually indicates that expectations for inflation and economic growth are falling.

The market interest rate on public debt has been falling for a long time, but this is not yet fully reflected in the interest expenses of government debt. This is because previous bonds of long maturity continue to have an impact on the debt stock for a long time. For this reason, the interest rates on the existing debt stock do not react to changes in market interest rates in real time.[16] During the past decade, the interest rate on new debt has been mainly falling, and the interest rate on loans that are taken now is lower than that of loans that are about to mature. The extremely high gross borrowing in 2020 (more than EUR 40 billion by the end of October if repayments of matured loans are not deducted) has been implemented at a negative, practically zero interest (Figure 17)[17]. If market interest rates remain unchanged, the effective interest rate on government debt, i.e. the ratio of total interest payments to the amount of debt, would thus continue to fall. Correspondingly, even if the market interests on government debt increased, the effective interest rate would not necessarily be up.

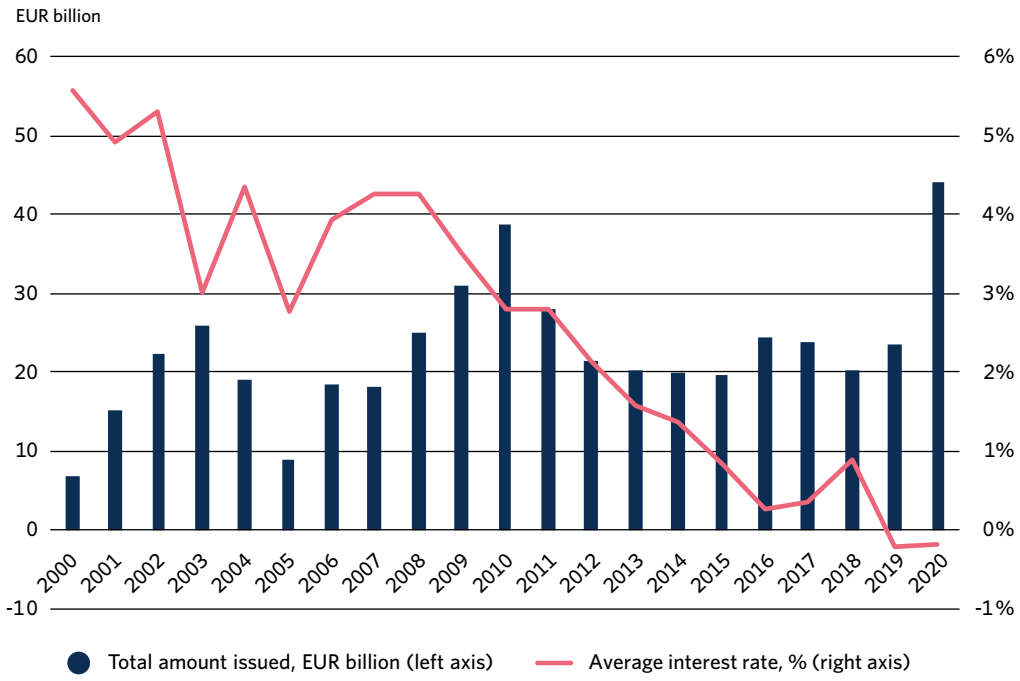

Figure 17: Government bonds issued in 2000–2020 and actual average interest rate (yield) on the issues. The average interest rate has been calculated as a weighted average based on the issues whose interest rates have been published on the website of the State Treasury. Because the methods of issue and the maturity of the bonds vary, the interest rates for different years in the figure do not illustrate the interest rates on bonds of the same maturity. As for 2020, the figure is based on information up until 28 October. Source: State Treasury and NAOF.

For this reason, even a rapid growth in the government debt-to-GDP ratio does not automatically mean that the debt level becomes unsustainable. It is possible to maintain and refinance even higher government debt with reasonable costs if the interest rates remain stable. There is no immediate need to start paying down the debt quickly. First, this might cause significant social expenses and slow down the economic growth. Second, this might be unnecessary for debt sustainability in view of the current interest rate environment. Low interest rates impact debt sustainability in such a manner that general government can maintain higher debt levels.

There are several possible reasons for the low interest rates. The monetary policy measures taken by central banks have supported for instance the demand for government bonds and thereby lowered their interest rates. It is extremely difficult to estimate when the Eurosystem could withdraw from the bond purchase programmes that have continued for years.[18] The purchase programmes have a long-term impact on market interest

A higher debt level does not immediately cause a significant increase in the annual interest payments.

rates because, for example, their impact does not end when the net purchases under the programmes end. The impact continues for a long time if the purchased bonds remain in the balance sheets of national central banks and if the buy-ins of maturing bonds are continued. For example, the net asset purchases under the ECB's latest purchase programme, i.e. the pandemic emergency purchase programme (PEPP), will terminate in June 2021 at the earliest. The maturing principal payments from securities purchased under the PEPP will be reinvested until at least the end of 2022, and the future roll-off of the PEPP portfolio will be managed to avoid interference with the appropriate monetary stance.

In addition to monetary policy, there may also be more fundamental underlying reasons for the low interest rates. According to Blanchard et al.[19], some of them lower the yields on all investments and thereby also the interest rates on public debt. For example, an ageing population, a decrease in the prices of investment goods relative to commodities, and widening income gaps would increase saving in relation to investments and thereby lower the yields of all types of investments. Other factors, in turn, would have an impact on the demand for safe investments, in particular, such as government bonds, and thereby lower their interest rates compared with higher-risk investments. One of such factors is more stringent financial regulation.

According to Blanchard et al., it is unlikely that the underlying reasons for low interest rates on public debt will change quickly.[20] Based on this, they consider that low interest rates are no short-term phenomenon. They also point out that governments can ensure long-term funding at very low interest rates by issuing long-maturity bonds. On the other hand, economic literature also highlights factors that may cause the interest rate to increase. Goodhart and Pradhan[21] consider that the ageing of the population reduces the household savings ratio.

Low interest rates may cause pressures to adjust the earnings-based pension scheme

In addition to debt sustainability, the development of the value of government assets has an impact on the sustainability of general government finances. In Finland, the amount of earnings-based pension assets is high in relation to public debt. A major part of the pension assets has been placed in equity-linked investments, the return on which is typically considered to be the sum of the return on a risk-free investment (e.g. government bond) and a risk premium required on top of it.

In view of the sustainability of general government finances, the risk is that, in addition to fixed-income investments, the returns on equity-linked investments would also decrease at the same rate as the returns on government bonds in the portfolios of pension insurance companies. This would mean that the drawback caused to general government finances by the decrease in the returns on pension assets would exceed the total benefit resulting from low interest rates. In addition to demographic factors, for example, this would increase pressures to make changes to the earnings-based pension scheme.[22]

The above-described risk of lower expected return on pension assets is largely based on the assumption that if risk-free return decreases, the equity risk premium remains unchanged. This means that the total expected return on equity investments falls. In practice, however, it is somewhat unclear how the present public debt interest rates are reflected in the return on other types of investments. Measuring the equity risk premium (ERP) involves both theoretical and practical problems. Drawing straightforward conclu-

sions on the relation between ultra-low interest rates and the return on equity assets is not fully unproblematic. The assumption that the risk premium remains stable over time may be particularly problematic.

According to studies[23], the equity risk premium seems to have been on a high level after the financial crisis compared with the pre-crisis level, whereas the interest rates on public debt have kept on falling after the crisis. If this is temporary, it is not particularly relevant to the assessment of the sustainability of general government finances. However, should this prove to continue for a longer period of time, it might mitigate the negative effects of potentially long-standing low interest rates on the return on public assets.

The risks of state guarantees are increasing, and EU-level decisions increase Finland's financial liabilities

State guarantees have been growing rapidly during the past ten years (Figure 18). During this period, especially export credit guarantees have been growing, although their growth has recently slowed down. No fiscal policy restrictions have been set for the amount of guarantees or the total risk they involve, although increases in guarantee authorizations require a government proposal and a decision by Parliament.[24] So far, the coronavirus crisis has not had an essential impact on the total level of state guarantees included in statistics. To support the liquidity of companies, the state has also introduced significant guarantee instruments, but by the date of the statistics, they have not been particularly widely used. Furthermore, there are constantly old guarantees that cease to be included in the guarantee stock, which slows down the growth of total guarantees.

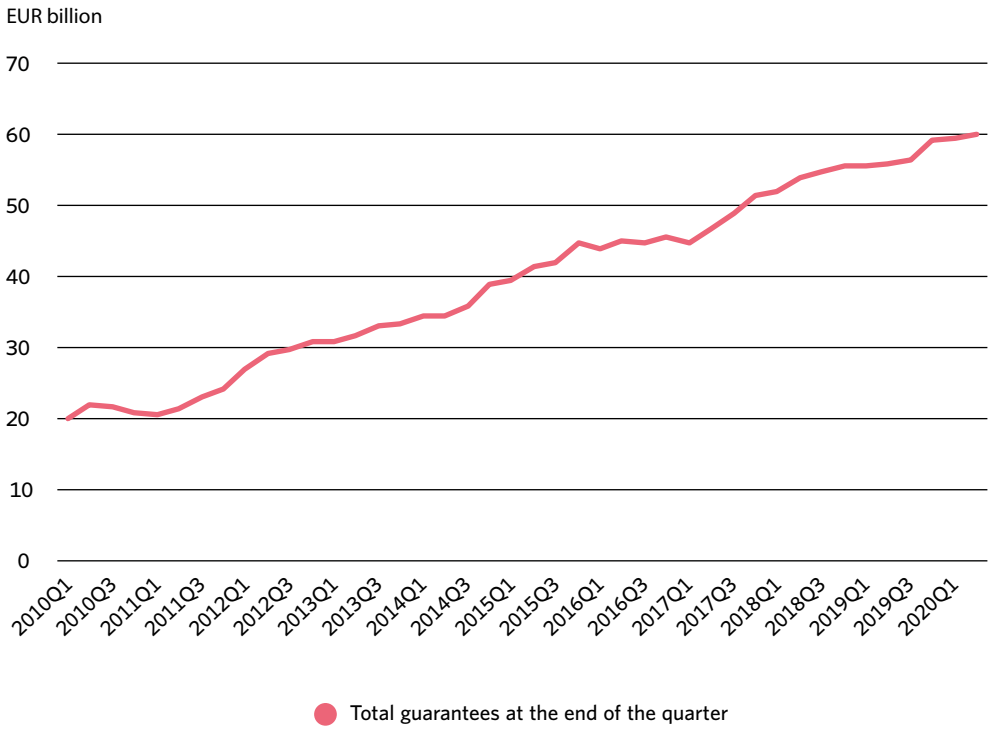

Figure 18: Development of state guarantees 2010–2020. Source: Statistics Finland.

> It is important to consider not only the risks involved in new EU liabilities but also the benefits brought by them.

The corona crisis has essentially aggravated the situation in the cruise industry, for example, which increases the risks involved in export credit guarantees. As a result of the bad debt reserves made so far, the buffer funds of the Finnvera Group to cover bad debts amounted to EUR 1.5 billion at the end of June. The sum consists of the Group's non-restricted equity and funds of the National Export Guarantee Fund. At the end of 2019, the buffer funds amounted to EUR 1.9 billion. If the corona crisis drags on, there is the risk that the buffer funds continue to decrease.

In the future, the increase in EU-level liabilities will also increase the liabilities of the State of Finland. The most important element causing new liabilities is the EU-level recovery instrument[25]. According to a negotiated solution, EUR 360 billion of the recovery instrument will be distributed to the Member States as loans and EUR 390 billion as grants. The part of the recovery instrument intended for financing the grants can be considered a liability that is certain to be realized in the Member States (the net position of each Member State depends on the funding received from the recovery instrument and the contribution to the EU budget). In this respect, a kind of accrued debt is concerned: the definitive expenditure, i.e. those projects of the Member States for which the funding is used, takes place before the payment is made. Finland's contribution to the funding in the form of grants is EUR 6.6 billion plus interests, which will fall for payment between 2028 and 2058. The part of the recovery instrument intended for support in the form of loans can be considered a guarantee-like contingent liability, which will only be realized if the lenders do not repay their loans.

When the recovery instrument is assessed from the perspective of debt sustainability, it is important to take into account not only the gross liabilities but also the funding it provides. In addition, it is important to consider how the instrument affects the recovery of the Member States from the economic impacts of the coronavirus. Through increased exports, its impacts may be channelled to Finland's economic growth. The EU Commission has simulated the impacts of the instrument. Based on these simulations[26], the gross domestic product, which increases as a result of growing exports, will essentially mitigate the impact of increased liabilities. These kinds of modellings involve a large number of uncertainties, but the results reflect the positive dynamic impacts that the instrument may have. In practice, how the funding provided by the instrument is used will naturally play a key role. Thus, the total economic impacts of the instrument depend essentially on the contents of the national recovery plan steering the use of the funding.

In addition to the recovery instrument, there are also other EU-level measures that have an impact on the amount of Finland's liabilities and the risks they involve. Table 1 illustrates the liabilities caused to Finland by new EU-level measures. The maximum volume of the new Pandemic Crisis Support (PCS) instrument provided by the European Stability Mechanism (ESM) is EUR 240 billion, of which Finland's share would be about EUR 4.3 billion. The PCS is implemented by means of the ESM's current capital. However, any new financial support that may be provided by the ESM will increase the state's risks as regards the callable capital of the ESM. The European Investment Bank (EIB)

has decided to establish a new EUR 25 billion Pan-European Guarantee Fund, where Finland's guarantee liability would amount to a maximum of about EUR 371.2 million. The EU has also established an instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE). In the SURE instrument, a major part (EUR 75 billion) of the securities for the instrument's borrowing is implemented utilizing the margin of manoeuvre provided by the EU's own resources. However, a smaller part (EUR 25 billion) is covered by guarantee arrangements, to which Finland's contribution is EUR 432 million.

At the end of 2019, state guarantees totalled EUR 59 billion (Figure 18). The contingent liability resulting from the share of the loans provided by the recovery instrument would account for about 10 per cent of this, while the accrued debt corresponding to the share of the grants would account for about 11 per cent.

Table 1: Liabilities caused to Finland by EU-level measures taken in connection with the coronavirus crisis. Source: MoF and NAOF.

EU-level liability	Finland's liability	Description of the formation of the liability
Recovery instrument, accrued debt	EUR 6.6 billion	Finland's gross share of the grants provided by the recovery instrument without interests. The funding received by Finland has not been deducted. Implemented based on the extended margin of manoeuvre provided by the decision on own resources in the EU budget and falls due for payment in 2028–2058.
Recovery instrument, contingent liability	EUR 6.1 billion	Finland's share of the funding of the loans provided by the recovery instrument. Implemented based on the extended margin of manoeuvre provided by the decision on own resources in the EU budget.
The Pandemic Crisis Support instrument of the European Stability Mechanism (ESM)	No actual new liability, as it has no impact on the maximum amount of Finland's ESM liabilities.	Does not cause an immediate need for new capital but increases Finland's risks as regards the callable capitalof the ESM. If the Member States used a maximum amount of the new financial support and the support were not paid back in full, Finland's computational share of this would amount to EUR 4.2 billion.
Pan-European Guarantee Fund established in connection with the European Investment Bank (EIB)	EUR 0.4 billion	Finland's guarantee liability for the fund.
EU instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE)	EUR 0.4 billion (guarantee arrangement) and EUR 1.3 billion (margin of manoeuvre in the EU's own resources)	A major part of the guarantees for the instrument's borrowing is implemented within the margin of manoeuvre provided by the EU's own resources. A smaller part is covered by guarantee arrangements.

2.2 The sustainability roadmap should be supplemented to make it an effective tool for stabilizing the debt ratio

In 2020, the sustainability roadmap has become one of the Government's key tools for improving the sustainability of general government finances. In the first phase of the sustainability roadmap in June 2020, the Government set as objective to stabilize the government debt-to-GDP ratio by the end of the decade. The National Audit Office considers the Government's objective justified. Although interest rates are expected to remain low in the near future, it is unknown how long the situation will continue.

Growing indebtedness increases the risk that maturing debt will be replaced with new debt at an essentially higher interest rate. In this case, interest payments would start to burden public finances considerably more than at present. To mitigate this risk, it is necessary to stabilize the government debt-to-GDP ratio. The sustainability roadmap aims at temporary stabilization of the debt ratio. However, this is not enough to fully remove the structural imbalance of general government finances.

> It is necessary to stabilize the debt ratio, as the management of public finances should not be based on the assumption of permanently low interest rates.

It would be important to, as soon as possible, achieve a situation where the debt ratio can be clearly reduced during an economic upturn and where it is allowed to increase only for stimulus measures during a downturn. Therefore, stabilization of the debt ratio should be regarded as a structural objective, i.e. as stabilization of the debt ratio in view of the cyclical conditions. The ageing population causes risks to the long-term development of expenditure, which complicates the situation. To achieve the above-described stabilization of the government debt ratio once the impacts of the crisis have become less strong, Finland should take both structural measures and, in the future, possibly also measures that have a direct impact on general government revenue and expenditure.

In the budget session of September 2020, the Government specified the measures for improving the sustainability of general government finances. The Government is planning to make further specifications in the budget session of 2021. The Government's list of measures includes mainly structural measures (employment measures, in particular) but does not exclude direct fiscal policy measures. According to the Government's press release on the sustainability roadmap, the Government is committed to taking new measures and resorting to measures that have a rapid impact on general government revenue and expenditure if the structural reforms and growth-boosting reforms being prepared are not enough to strengthen public finances as intended.

It is good that measures for improving the sustainability of general government finances are prepared systematically. The roadmap and the underlying objective to stabilize the debt ratio could be a useful tool for planning sustainability improvements even beyond parliamentary terms.

The sustainability roadmap of autumn 2020 is a step in the right direction but should, nevertheless, be specified in the future. As stated above, the underlying objective to stabilize the debt ratio is highly justified. In the present situation, it is also justified that, in-

stead of direct revenue and expenditure adjustments, the roadmap focuses on structural measures. This makes it possible to secure economic growth when the medium-term debt sustainability outlook is relatively good. Furthermore, the contents of the roadmap are based on measures that, on the basis of the available information, would in principle have potential to improve the sustainability of public finances.

At this stage, however, the roadmap is too generally formulated, which should be taken into account in the update to be made in the spring of 2021. First, the measures should be specified in concrete terms to make it possible to evaluate the realism of their implementation and the desired impacts. Second, better estimates should be given, to the extent possible, of the impacts of the planned measures on general government finances. Unemployment, for example, can be improved in different ways, and these alternative ways can have very different impacts on public finances. As regards employment measures, the contents of the roadmap are discussed in greater detail in chapter 3 of this report.

The size of the measures set out in the sustainability roadmap is essentially based on the scenarios of the Ministry of Finance on the development of government debt. Therefore, the defined need for strengthening public finances is essentially dependent on the quality of these scenarios. At present, the calculated strengthening need is EUR 5 billion. If this were implemented, the debt ratio would be stabilized in the 2020s. According to the assessments made by the National Audit Office, the medium-term and long-term projections prepared by the Ministry of Finance are generally of high quality.[27] However, this does not remove the high degree of uncertainty that debt scenarios inevitably and naturally involve. Thus, it would be essential to point this uncertainty out in the sustainability roadmap. Uncertainties and alternative calculation assumptions can also have an essential effect on the strengthening need.

An example of the uncertainties in debt scenario calculations is the impact of the interest assumption on debt development. The National Audit Office estimates that, at the current debt level, decreasing the assumed interest on public debt by one percentage point for a period of 10 years, for example, would result in at least 5 percentage points lower debt ratio at the end of the review period. The sensitivity has increased, because government debt relative to GDP is increasing sharply on account of the corona crisis, for example, whereby even relatively small changes in the interest rate have a greater impact than before. The debt scenarios of the Ministry of Finance on which the roadmap is based include an assumption that the implicit interest rate on public debt, i.e. the ratio of interest payments to debt, will be about 2 per cent at the end of the 2020s and 4 per cent at the beginning of the 2040s. These interest rate assumptions are an example of factors that may change over the coming years, and thus they may cause essential changes to the debt scenarios.

However, it is not possible to avoid this kind of uncertainty in longer-term calculations, as even the near future involves a great deal of uncertainty. In any case, it would be important to take uncertainty into account in tools for long-term planning and steering of public finances, such as the sustainability roadmap. This could be done, for example,

> The sustainability roadmap should prepare for changes in the amount of adjustment required for stabilizing the debt ratio.

by presenting sensitivity analyses in connection with the roadmap of how much public finances should be strengthened in order for the debt ratio to be stabilized. The sensitivity analyses should examine how the amount of adjustment changes when the underlying assumptions are changed. The sustainability roadmap should, moreover, define in advance how often the estimated amount of adjustment required for the stabilization is to be updated. As the estimate can change in either direction even rapidly, it would be necessary to define procedures for such situations in advance in order to ensure coherent and long-term fiscal policy.

The sustainability roadmap includes a moderate cost-savings potential for the health and social services reform

The sustainability roadmap also describes the impact of the funding model proposed for the health and social services reform on health and social services expenses. According to the roadmap, the planned funding model included in the Government's proposal (June 2020) can curb growth in the expenditure by 2029 by a maximum of about EUR 0.5 billion[28]. As a basic premise, the proposed health and social services reform makes it possible to achieve cost benefits compared with the present organization of health and social services. Although it will take time before the cost benefits are realized, and they will not be automatic, larger service organizer 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 digitalization or management systems).

In relation to these theoretically potential cost benefits, the maximum impact of EUR 0.5 billion entered in the sustainability roadmap can be considered justified. The impact of the change costs related to the reform can be expected to be mitigated by 2029, and by that time, the reform can be expected to have resulted in efficiency gains. However, there are uncertainties involved in this: the harmonization of salaries, for example, may increase the health and social services expenses for a long term or even permanently. Furthermore, the maximum potential of EUR 0.5 billion is based on the assumption that counties will not resort at all to the additional funding enabled by the funding model.

Although there are limited possibilities of curbing the development of costs in the 2020s, it is important that the health and social services reform supports the long-term sustainability of general government finances as well as possible. The maximum impact entered in the roadmap can be considered modest from the perspective of sustainable public finances. At the same time, however, it should be observed that the roadmap also aims at improving the productivity of health and social services as part of the productivity of all public services. In the future, the sustainability roadmap should also give an overall picture of how much the streamlining of health and social services aims to strengthen public finances.

Introduction of a debt ceiling would be a challenge in the present situation

One of the topics in fiscal policy debate has been whether a ceiling should be set for the government debt-to-GDP ratio to support the fiscal policy framework. So far, a key reference value in fiscal policy has been the 60 per cent reference value set out in the EU's Stability and Growth Pact. For the time being, it is unknown how long the escape clause (see section 1.4) activated in the EU's fiscal rules will remain in force. It is also unclear what kind of significance the application of the 60 per cent reference value would have in practice in the current situation where the debt level of the euro area was already significantly above the reference value before the corona crisis and where the crisis continues to raise the debt levels further away from the target.

Adding the importance of numeric, possibly Member-State-specific debt objectives has been considered a way to contribute to the simplification of the present EU fiscal framework.[29] Another benefit of the debt objective or ceiling might be, for example, that it could serve as a fiscal policy benchmark, which would contribute to more longer-term fiscal policy. However, there are several issues that should be taken into account in the definition and application of a possible debt ceiling.

First, it would be very difficult for some time to define a debt ceiling that would be both realistic and sufficiently stringent. Because of the corona crisis, the outlook for the coming years continues to be exceptionally uncertain. At present, there is a great deal of uncertainty about what the government debt-to-GDP ratio will typically be in the euro area and on what level it should be in order to be considered economically sustainable.

It is unclear on what level it would be justified to set the debt ceiling.

Second, a debt ceiling or objective should not lead to fiscal policy decisions that are not optimal but made for technical reasons. An example of this could be a situation where a state is about to exceed the debt ceiling but by selling its equity assets, manages to remain below the ceiling. If this decision were based only on the ambition to fall below the ceiling instead of an economic analysis of return on the equity assets and the interest rates on government debt, the debt ceiling would not serve its ultimate goal, i.e. promoting sustainable general government finances.

Another example of a risk of a technical nature related to the debt ceiling has to do with how public debt is entered in statistics. Statistical offices keep considering whether various publicly owned entities should be classified as entities within or outside the public administration. Over the years, Statistics Finland has discussed the classification of Finnvera, for example, with Eurostat, because this has a fairly significant impact on the government debt ratio. If the debt level fell only slightly below the debt ceiling and the statistical classification were changed in this kind of situation, the debt ceiling might be breached. Trying to avoid breaching the ceiling by taking quick decisions might lead to fiscal policy decisions that are economically poorly justified. On the other hand, if a statistical change reduced the debt-to-GDP ratio, this could unduly give an impression of an extended fiscal space.

3 Employment measures are still far from reaching the target set for their impact on general government finances

The Government's original employment targets were tied in the Government Programme to normal global economic circumstances. In the autumn of 2020, the Government set an employment target that was more ambitious than the previous one but had a more flexible timetable. It was good that the Government did not give up striving for higher employment despite the corona crisis.

The Government's sustainability roadmap sets a clear quantitative objective for how much the new employment target should strengthen general government finances. However, the sustainability roadmap and the employment target set in the budget session of autumn 2020 do not form a uniform whole. The schedule of employment measures is not consistent with the debt sustainability calculation on which the sustainability roadmap is based. Moreover, when the impacts of the employment measures are assessed by micro methods, the objectives set by the sustainability roadmap for general government finances will not be achieved. This does not mean that the objective cannot ultimately be reached in practice, but the tools currently available simply do not make it possible to take into account some of the potential impacts of the measures. This makes it difficult to measure the objective. The employment measures of the budget session also include a measure that should not be included in the adjustment objective of the sustainability roadmap, as it has already been taken into account in the baseline scenario of the underlying debt sustainability calculation.

The National Audit Office assesses that the employment decisions taken so far during the parliamentary term have rather modest impacts on general government finances. There is a risk that the desired impacts on public finances would not be achieved even if employment improved as described in the sustainability roadmap. The current version of the roadmap is based on the optimistic assumption that the employment measures to be implemented will not cause any costs to general government.

3.1 Employment targets were changed as a result of the corona crisis

Employment targets have played a key role in the Government's economic policy. The ageing population and the growing health and social services costs cause challenges to the long-term sustainability of public finances. Different Governments have proposed employment as a key means of strengthening the sustainability of public finances. According

Employment measures aim to strengthen general government finances.

to both the Government Programme of 2019 and the present Government's sustainability roadmap and budget proposal for 2021, employment measures aim to improve the sustainability of public finances.

In connection with the budget session of autumn 2020, the Government changed and adjusted its employment target. The economic crisis caused by the coronavirus and its impact on public indebtedness have changed the objective of employment measures to some extent. According to the Government Programme, the aim was to strengthen the sustainability of public finances in such a manner that unsustainable indebtedness could be avoided in the long term. According to the present sustainability roadmap, in turn, employment measures and other measures aim to stabilize the government debt-to-GDP ratio by the end of the 2020s.

The new employment target also differs from the old one in many other respects. Table 3.1 presents the employment targets and their key features. The original employment target set out in the Government Programme was to increase the number of employed people by at least 60,000 by the end of 2023. This means that decisions on measures should have been taken and the impacts of the measures should have been realized by the end of 2023. The original intermediate target was to decide by the budget session of autumn 2020 on the measures that will result in 30,000 new employed people by the end of 2023.

Of the conditions linked to the original employment target, the condition according to which the target is valid only in normal economic circumstances proved to be important because of the corona crisis. The coronavirus has caused a deep recession in 2020, and it is now possible to interpret the Government Programme in such a manner that the original target is no longer valid. Other key conditions were that the measures should be structural, and that any measures that have a negative employment impact should be offset by employment-boosting measures.

Table 2: Employment targets and their key features. Source: Government Programme, budget proposal for 2021, employment measures of the budget session, and sustainability roadmap.

Target	Content	Schedule	Conditions
Employment target of Rinne's/Marin's Government Source: Government Programme of 6 June 2019 and budget proposal for 2021, 5 October 2020	Main target: • Raising the employment rate to 75 per cent (in the age group 15–64 years). • The number of employed people increases by at least 60,000. Intermediate target: • The number of employed people increases by 30,000.	• The measures have been decided and the employment impact has been realized by the end of 2023.	• The measures are structural. • The target is valid in normal global economic circumstances, which are reflected in the domestic economic situation. • Any employment measures that have negative employment impacts are offset by employment-boosting measures.
Revised employment target of Marin's Government Source: Employment measures of the budget session, sustainability roadmap of 16 September 2020, and budget proposal for 2021, 5 October 2020.	Main target: • The number of employed people increases by 80,000. Target according to the employment measures of autumn 2020: • The number of employed people increases by 31,000–36,000 as a result of the decisions taken before and during the 2021 budget session.	• Decisions on measures are taken during the Government term. • The impacts of the measures will be realized by 2029.	• The target is explicitly linked with the Government's sustainability roadmap. • The measures will strengthen public finances by EUR 2 billion.

In the budget session of autumn 2020, the Government revised and adjusted its employment target. The main target is to increase the number of employed people by 80,000. In the budget session, the Government also proposed decisions which, together with the previously taken employment-boosting measures, aim at increasing the number of employed people by 31,000–36,000. This can be considered an intermediate target. The schedule of the measures has also changed. Decisions on measures will be taken during the Government term, but the impacts of the measures will be realized by 2029.

The conditions applied to the employment target have also changed to some extent. The employment target set out in the Government Programme did not involve an explicit, quantitative objective for the impact of employment measures on the balance of general government finances. The present employment target, in turn, aims to strengthen public finances by EUR 2 billion. According to the Government's sustainability roadmap, employment measures are part of a whole that aims to stabilize the government debt-to-GDP ratio by the end of the 2020s.

> A good employment target is simple, clearly defined, measurable, and realistic.

It is good that the Government did not abandon its employment targets because of the corona crisis. The impact of the crisis on general government finances – especially the rapid growth in government debt and the labour market impacts – underline the importance of an explicit employment target. The existence of a target may contribute to strengthening general government finances.[30]

Lars Calmfors, Professor of International Economics, describes the features of a good employment policy target as follows: An employment target should be simple and well-defined such that its achievement is verifiable. It should also be realistic and help achieve the final objective (i.e. in this case, strengthen general government finances). Finally, targets should be few, as a large number of targets may diminish the status of each target.

When the Government's objectives are assessed against these criteria, it can be stated that it is highly justifiable that the Government has kept the employment target and adjusted it as the circumstances have changed. It is essential that the target has been adjusted, as the original employment rate target of 75 per cent by the end of 2023 would probably not have been very realistic after the coronavirus shock.

Both the old and the new target are primarily simple and focused on increasing the employment rate. The employment rate is measured by a labour force survey where a person is considered to be employed if they have been employed at least one hour during the survey week When measured like this, new employed people may only have a minor impact on public finances. For this reason, Calmfors proposes that there should be two employment targets: in addition to aiming at a certain number of new employed people, the Government should also set a target related to the actual annual hours worked per person. The latter target would be especially important when the objective is to strengthen general government finances.

The Government's employment measures lack a target based on hours worked. On the other hand, the new employment objective is directly linked with the sustainability roadmap, and its potential impact on public finances is stated to be EUR 2 billion. This means that monitoring and measuring the achievement of the objective is not limited to the employment impacts of the measures but also covers their impacts on public finances. In this sense, the new target can be considered to better promote the Government's main objective, i.e. to stabilize the government debt-to-GDP ratio by the end of the 2020s. The old target was not as clearly linked with strengthening public finances. However, it should also be observed that, as the new target is linked with the sustainability roadmap, it may have become more complicated and may even be defined in a contradictory manner.

3.2 The employment target set in the budget session in 2020 is not clearly linked with the sustainability roadmap

Under the sustainability roadmap, the Government's objective is to stabilize the government debt-to-GDP ratio. According to the debt sustainability calculations of the Ministry of Finance, this requires that general government finances be strengthened by EUR 5 billion. Based on this, the Government has prepared sets of measures whose combined potential impact on public finances is EUR 4.5 billion. One of these sets consists of employment measures.

The debt sustainability calculations of the Ministry of Finance show that adjustment measures of EUR 5 billion are enough for stabilizing the debt ratio in the 2020s, assuming that the measures taken are of a permanent nature and implemented between 2023 and 2025.[31] This means that the impacts of the measures should be realized between 2023 and 2025 in order for the EUR 5 billion adjustment to be sufficient. The sustainability roadmap is based on this calculation. However, in the budget session documents, the Government states that the impacts of the measures will be realized by the end of 2029. Therefore, the schedule defined by the Government is not consistent with the debt sustainability calculation on which the sustainability roadmap is based. The Economic Policy Council has also paid attention to this.[32]

> The schedules of the employment measures set out in the budget session and the sustainability roadmap do not coincide.

Mere employment measures are assessed to be able to strengthen public finances by EUR 2 billion. This assessment is based on the sensitivity analysis of the sustainability gap calculation (Economic Survey, Autumn 2020, table 27). The sensitivity analysis describes the impacts of changes in various background assumptions on the sustainability gap. From the sensitivity analyses, it is possible to deduce that one new employed person should strengthen public finances by EUR 25,000 on average.[33] (It is assumed in the calculation that about 70 per cent of new employed people would move to employment from unemployment and the rest would move to employment from outside the labour force.) This refers to the potential of the measures, as any costs the measures may cause to public finances must be deducted from the EUR 25,000 impact per new employed person. Based on the calculation, employment measures can thus strengthen general government finances by EUR 2 billion at best, provided that they cause no costs at all.

When the issue is examined from the perspective of a single new employed person, the EUR 25,000 impact on public finances, derived from the sustainability gap calculation, is a demanding target. Furthermore, in the sustainability gap calculation, the magnitude of

> When the impacts of employment measures are assessed by conventional microeconomic-level methods, it becomes evident that the fiscal targets set out in the sustainability roadmap will not be achieved.

the impact is based on the sustainability gap framework, i.e on the macroeconomic-level calculation describing the macroeconomic perspective, which is usually not used when individual employment measures are estimated. It appears from the Government Programme and related background calculations that the impacts of employment measures are primarily estimated on the basis of microeconomic-level calculations, i.e. on the individual or household level, for example by means of the SISU microsimulation model.[34] This may complicate the measuring of the achievement of the employment target.

Alasalmi et al. (2019)[35] have examined the costs caused by unemployment to public finances more comprehensively in the publication series of the Government's analysis, assessment and research activities. They present several calculations on the impact on public finances of one unemployed person who finds full-time employment. In addition to benefit expenditure, the calculations take account of the costs of services (e.g. employment services) and lost tax revenue. According to the study, the average impact on public finances of an unemployed person who finds full-time employment is about EUR 21,500 per year.[36]

In the background memo of the Economic Policy Council, Seuri (2020)[37] studies the fiscal effects of employment growth. In the memo, it is estimated as a possible approach based on the SISU model how much an unemployed person who finds full-time employment for a year would impact public finances under different employment wage assumptions. In the baseline scenario of the memo, the impact of direct taxes is calculated based on the forecast wage. In addition to tax revenue, the calculation takes account of benefit expenditure but not the costs of services. The study shows that the impact of one newly-employed individual on public finances, based on this approach, is about EUR 18,000 per year. Most of the savings in benefit expenditure come from unemployment security. The newly-employed may also have less need for other benefits, depending on the employment measures within the scope of which they are.

The Ministry of Finance has drawn up a background memo[38] on the increase in the income threshold of early childhood education. From this memo, it appears that the impact of about 3,000 new employed people on public finances is about EUR 40 million, which comes from tax revenue and social security savings. Calculated in this manner, the impact per a new employed individual is about EUR 13,300. The calculation has been made by means of the SISU model, for example. The difference from the previously presented microeconomic-level figures is mainly caused by the fact that, in the calculation of the memo, people move from the scope of home care allowance instead of unemployment security.

The difference between the EUR 25,000 impact based on the sustainability gap calculation and the EUR 18,000–21,500 impact based on the individual-level calculations is caused by several factors. To begin with, the models have fundamentally different background assumptions and starting points. The sustainability gap calculation is a long-term macroeconomic-level calculation, whereas impact assessments are made on the individual or household level. In the microeconomic and macroeconomic-level calculations, the magnitude of the impact depends on the assumed employment wage, the duration of the employment, and the social security benefit from which the person enters employment. These assumptions may be different on the micro and macro levels. Particularly the group of social security benefit from which the person enters employment can be studied in far greater detail on the microeconomic level than on the macroeconomic one. This is an essential factor, which appears, for example, in connection with the reform of early childhood education: its estimated impact per a new employed individual is only EUR 13,000.

In the sustainability gap calculation, it is assumed that 30% of the new employed come from outside the labour force and 70% from the unemployed. In the microeconomic-level calculations of Alasalmi et al. (2019) and Seuri (2020), in turn, it is assumed that all new employed people come from the unemployed, which increases the potential savings in social security benefit expenses.[39] This reduces the difference between the microeconomic and macroeconomic level but underlines the fact that the figures are not easy to compare.

The calculations of Alasalmi et al. also ignored the employer's social security contributions and indirect taxation.[40] As a basic premise, the publication's calculations and also impact assessment only take account of the direct consequences of employment, which are often measured only in the short term. Nor does the impact assessment take into account the pension that is accumulated from additional work and that will fall for payment later.[41]

The above-described difference between the macroeconomic and microeconomic-level calculations does not mean that the targeted EUR 25,000 net impact per a new employed person would be unrealistic in the long term. However, it shows that if the impact assessment is made with conventional micoeconomic tools, it is difficult to achieve an average impact of EUR 25,000 on general government finances. This makes it more difficult to measure the EUR 2 billion adjustment target linked with the employment target.

The impact of the rise in the age limit for the right to additional days of UI should not be included in the adjustment measures of the sustainability roadmap, as it has already been taken into account in the baseline scenario of the sustainability gap calculation.

The inadequate connection between the Government's employment measures and the sustainability roadmap is also illustrated by the fact that the rise in the age limit for the right to additional days of unemployment security in 2020 has been taken into account in the sustainability gap pressure projection, but its employment impact (6,500 to 7,000 new employed people) is included in the 80,000 new employed people, i.e. the EUR 2 billion adjustment measures.[42] This is problematic, as it means that the rise in the age limit is taken into account twice.

3.3 The employment measures decided so far have only a small impact on public finances compared with the target

In the budget session of 2020, the Government presented a list of employment measures to achieve a total of 31,000–36,000 new employed people. When the impact of the rise in the age limit for the right of additional days of unemployment security, which was already included in the sustainability gap calculation, is deducted, and when those measures taken during the parliamentary term which are estimated to have negative employment impacts are taken into account, the total number of new employed people is about 7,500–18,600. To make a very rough estimate, the total impact of the employment measures on general government finances is about EUR 49 to +260 million.[43] This falls far short of the EUR 2 billion adjustment potential defined for the measures.

The Government's list includes measures on which decisions were already taken before the budget session of this autumn as well as new measures decided in the budget session. The most significant measures are the Nordic employment service model (9,500–10,000 new employed people) and the rise in the age limit for the right of additional days of unemployment security (6,500–7,000 new employed people)[44]. In addition to these, the list includes an assignment for the labour market organizations, which is planned to result in 10,000–12,000 new employed people. Some of the impact assessments of the Ministry of Finance are preliminary, as the details of many measures are still open. Based on the assessment of the National Audit Office, these impact assessments have been prepared carefully, considering the uncertainty associated with the open details.

To get an overall picture of the employment measures taken so far during the parliamentary term, it is necessary to examine not only the employment measures according to the list of the budget session of autumn 2020 but also such measures taken during the parliamentary term that are expected to have negative impacts on employment. Measures that have a negative employment impact (e.g. the rise in the benefit level) can have a negative impact on general government finances as well. Therefore, such measures must be taken into account in the overall examination. Such measures can be considered to include the removal of the cuttings of the activation model of unemployed persons (5,000–12,000 fewer new employed)[45] and some of the measures decided in the 2019 budget session, such as increases in basic social security (5,000 fewer employed).

The rise in the minimum age limit for the right of additional days of unemployment security has been included in the basic forecast for a long time, although the Government proposal regarding it was not given and adopted until in 2019. Therefore, it is unclear how it impacts the examination of employment now that it is included in the Government's list as a new measure. If the factors mentioned in the preceding paragraph are taken into account as measures reducing the number of new employed people and if it is assumed that the assignment given to the labour market organizations results in the targeted number of new employed people, the number of the new employed from the beginning of the parliamentary term to the budget session would thus be about 7,500–18,600.

The impact assessment made by the Ministry of Finance of the employment measures of the budget session of 2020 is limited to the number of the new employed and does not cover the impact of the measures on public finances except in the case of reduction of the fees for early childhood education. However, even rough estimates can be useful, as they may help in the further preparation of the measures. The total impact of the measures already taken on public finances shows roughly the adjustment need in relation to the EUR 2 billion mentioned in the sustainability roadmap.

Table 3 shows indicative estimates of the potential impacts of the employment measures taken during the parliamentary term on general government finances. The estimates are preliminary and aim at identifying whether the impacts are positive or negative. Another aim is to give a rough estimate of the magnitude of the impacts. For the reasons described above in this chapter, the ambition has been to estimate the impacts on both microeconomic and macroeconomic level. The estimates presented are no actual impact assessments of measures to be specified later but estimates for illustrating the magnitude of the impacts on public finances.

When employment-reducing measures are taken into account, the potential total number of new employed people is about 7,500–18,600.

Table 3: Indicative estimates of the impacts of employment measure taken during the parliamentary term on public finances

Measure	Number of new employed	Net impact on public finances (microeconomic level), EUR million	Net impact on public finances (macro-economic level), EUR million
Rise in the minimum age limit for the right of additional days of UI	6,500 to 7,000	+117 to +126	+162.5 to +175
Nordic employment service model	9,500 to 10,000	+101 to +110	+167.5 to +180
Increase in the employment rate of people aged over 55 (assignment for labour market organizations)	10,000 to 12,000	+180 to +216[46]	+250 to +300
Reduction in the fees for early childhood education	2,500 to 3,600	−100	−66
Extension of compulsory education	1,600	−89 to −11	−72 to +6
Linear model of partial disability pension	200	no estimate	no estimate
Reform of adult education allowance	200	no estimate	no estimate
Reform of pay subsidy	500 to 1 000	no estimate	no estimate
Government's (intermediate) target	**31,000 to 36,000**	-	-

Other employment-related decisions (not included in the Government's list of measures)

Measure	Number of new employed	Net impact on public finances (microeconomic level), EUR million	Net impact on public finances (macro-economic level), EUR million
Removal of the cuttings of the activation model	−5,000 to −12,000	−255 to −129	−339 to −164
Budget proposal for 2020 (mainly increases in basic social security and tax changes)	−5,000	−90	−125
Total	**7,500 to 18,600**[47]	**−49 to +99**[48]	**+86 to +260**[48]

> The impact of employment measures on public finances is roughly EUR −49 to +260 million.

More detailed information on the estimated impacts of the measures on public finances is presented in the appendix to this report. The measures that have a negative impact on employment have been taken into account in the overall assessment. The impact of the rise in the minimum age limit for the right of additional days of unemployment security has not been taken into account. Only a fifth of the fiscal impact of the removal of the cuttings of the activation model has been taken into account. The impacts of smaller measures have not been estimated. On microeconomic level, the total impact on public finances calculated in this manner is very roughly about EUR −49 to +99 million.

On macroeconomic level, the total impact of the measures on general government finances is very roughly about EUR +86 to +260 million. The results are explained by the negative impact of four measures on public finances. However, it must be pointed out separately that one of these measures is raising the compulsory education age. Its impact has been calculated for 2029. The cost of this measure will then still exceed the benefit derived from it. In the longer term, however, the number of the new employed will grow, and the impact of the measures on public finances will become positive (background report of the Economic Policy Council 2018). This shows that a measure can strengthen public finances in the long term although it does not promote stabilization of government debt in the medium term.

Although the microeconomic and macroeconomic estimates have very different starting points, the combined impact of the measures on public finances is of similar magnitude in both estimates. This is mainly because the estimates have taken into account both employment-boosting and employment-reducing measures. In any case, both overall estimates show that the employment measures taken so far still fall far behind the EUR 2 billion adjustment potential defined for them.

4 The corona crisis makes economic forecasts exceptionally uncertain

The Ministry of Finance forecasts that the economy will turn around in the second half of 2020 and continue to grow in the next few years. 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.[49]

The National Audit Office assesses that the economic forecast of the Ministry of Finance on which the budget for 2021 is based is realistic, considering when it was prepared. The assumption made by the Ministry of Finance that the epidemic will not break out again is relatively consistent with the assumptions other forecasters made at the same time. However, the development of both the pandemic and restrictions has later globally increased the risk that the economic development will be weaker than forecast. On the other hand, quicker-than-expected introduction of a vaccine would probably speed up the recovery from the crisis. Thus, there are factors in sight that both weaken and strengthen the economic development and that have appeared after the forecast on which the next year's budget is based was prepared.

4.1 Forecasts are affected by assumptions about the duration of the epidemic and the arrival of a vaccine

The corona crisis has made it complicated to forecast economic development: it is difficult to predict the spreading of the epidemic, it is unknown when a vaccine becomes available, and the epidemic has large-scale impacts on the economy. As no-one knows precisely how the epidemic will develop, economic forecasters[50] have been forced to make assumptions concerning it for their forecasts.

In its forecast, the Ministry of Finance assumes that "there will not be any second coronavirus outbreak in Finland or in the rest of the world. However, the risks are there". The assumption is relatively consistent with those of the other forecasters, as most of them assume that the second wave of the epidemic will be moderate or will not take place and that large-scale restrictions like those implemented in spring 2020 will not be repeated.[51]

The forecasts have been prepared in the summer and early autumn of 2020[52], when the epidemic situation was still relatively calm although the number of cases were already increasing. However, in the light of the information available in November 2020, it seems that the epidemic is taking off again both in Finland and especially elsewhere in Europe, and countries have had to reintroduce restrictions. This means that the core assumption

> Restoring large-scale restrictions would break the background assumption of several forecasts and could lead to weaker economic development than forecast.

underlying the forecasts is in danger of breaking down. If the assumption breaks down, the downside risks of the forecasts may be realized, and the economic development may be weaker than forecast.

The arrival of coronavirus vaccines is considered significant for the economic recovery. Estimates of the arrival of vaccines vary, and there is no accurate information.

In its forecast, the Ministry of Finance does not comment in detail when it expects the Covid-19 vaccine to become available. It states that potential arrival of a vaccine in 2021 is the key positive risk in the forecast.[53] Most of the other forecasters do not comment on their expectations regarding the arrival of a vaccine at all. The forecasters that comment on this in detail expect a vaccine to become available in 2021 (Nordea, Etla, Pellervo Economic Research, Handelsbanken, IMF). Thus, the assumption of the Ministry of Finance can be considered more prudent than those of the forecasters that express their assumption clearly.

As information on the development of vaccines is updated over time and the epidemic situation keeps changing, the forecasters will monitor the situation. After the preparation of the forecast on which the budget was based, at the beginning of November 2020, positive news were received of the development of coronavirus vaccines: a vaccine may become available sooner than expected. According to the most optimistic estimates, a vaccine may already become available at the end of 2020, although there are still uncertainties. The positive news on vaccines and their quicker-than-expected arrival may lead to more positive economic development than expected.

4.2 The forecast of the Ministry of Finance on which the budget is based does not differ significantly from those of other forecasters

The Ministry of Finance forecasts that Finland's gross domestic product (GDP) will at first contract by 4.5 per cent in 2020 and then grow by 2.6 per cent in 2021 and by 1.7 per cent in 2022. The forecast for 2020 made this autumn is more positive than the median forecast (−5.0) and the mean (−5.4) of the forecasters of the Finnish economy. The forecasts on the development of GDP vary from −9.2 to −3.5 per cent, and on average, they have become more positive towards the autumn.

According to the forecast of the Ministry of Finance, the drop in the economic output was steepest in the second quarter of 2020, and the economy will pick up in the third quarter of 2020. If the Ministry's forecast proves to be correct, the economy would recover from the deepest slump more rapidly in the corona crisis than in the financial crisis. This can be seen in Figure 19, which shows the quarterly development[54] of GDP during the financial and corona crises. The figure also shows the magnitude of the GDP growth figures that the Ministry's forecast would imply in the second half of 2020[55]. In the figure,

the start of the recession[56] caused by the crises is shown after Q0. In other words, Q0 corresponds to the last quarter before the recessions, i.e. the last quarter of 2019 and the third quarter of 2008. However, the forecast involves uncertainty, which is shown in the figure by confidence intervals[57]. When the width of the confidence intervals is examined, it can be seen that a recession similar to the financial crisis is still a possibility. On the other hand, GDP development can also be more positive than projected, which is illustrated by the upper limit of the prediction interval.

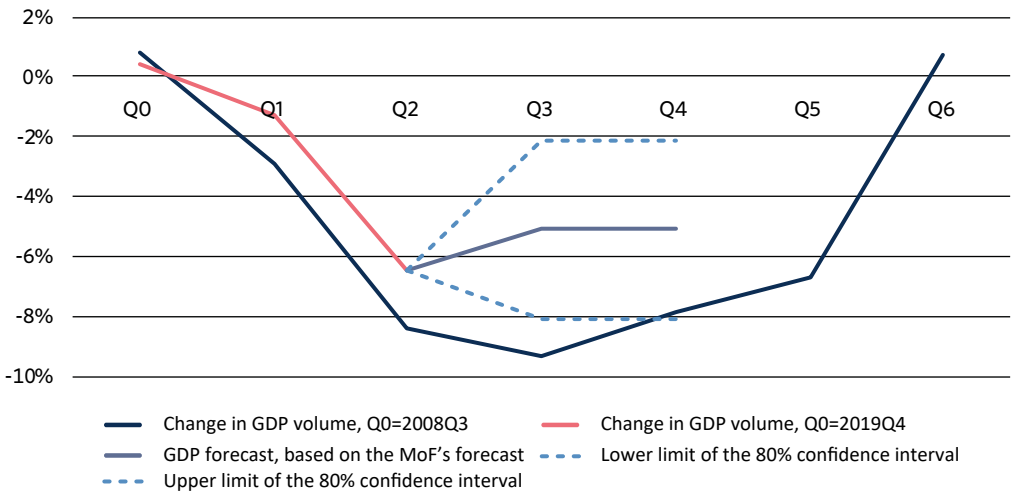

Figure 19: Quarterly change in GDP during the financial crisis and the corona crisis and forecasts of the Ministry of Finance. Quarterly year-on-year change in volume, %. Source: Statistics Finland, MoF, and NAOF.

By comparing the economic forecasts of the Ministry of Finance with those of the other forecasters, it is possible to get an idea of whether the Ministry's forecasts are roughly in line with those of the others (Table 4). Any deviations can be identified by examining whether the Ministry's forecasts fall within the range formed by picking out the most optimistic and pessimistic estimates of the other forecasts. Although deviations as such do not disclose the realism of the forecasts, they offer good starting points for examining whether the forecasters have similar understanding of the future economic development.

The Ministry of Finance forecasts that the Finnish economy will pick up more quickly than in the financial crisis, but uncertainty remains high.

Table 4: Comparison of the forecasts by the Ministry of Finance with the minimum and maximum limits formed of the forecasts by other economic forecasters and with 95% prediction intervals. Source: forecasters and NAOF.

Item	Level 2020	Level 2021	Level 2022	Item	Change 2020	Change 2021	Change 2022
GDP, EUR million	2	2	2	GDP, %	2	2	2
Imports, EUR million	2	2	1	Imports, %	2	2	2
Private consumption, EUR million	2	1	1	Private consumption, %	2	2	2
Public consumption, EUR million	2	2	2	Public consumption, %	2	2	1
Exports, EUR million	2	2	1	Exports, %	2	2	2
Investments, EUR million	2	2	1	Investments, %	2	2	2
Unemployment rate, %	2	2	2	Unemployment rate, % points	2	2	2
Employment rate, %	2	2	2	Employment rate, % points	2	2	2
Inflation, consumer price index	–	–	–	Inflation, %	2	2	2
Current account, % of GDP	2	2	2	Current account, % points	2	1	1
Government fiscal balance, % of GDP	2	2	2	Government fiscal balance, % points	2	2	2
Government gross debt, % of GDP	2	2	1	Government gross debt, % points	2	2	2

- The MoF forecast falls within the 95% prediction interval and the minimum–maximum interval.
- The MoF forecast falls outside the 95% prediction interval or the minimum–maximum interval.
- The MoF forecast falls outside the 95% prediction interval and the minimum–maximum interval.

The table shows that the forecasts are highly similar all along the line, and the forecasts of the Ministry of Finance fall within the interval formed of the forecasts of other forecasters especially in 2020. However, of the forecast years, there are most differences in the forecasts for 2020.[58]

Generally speaking, the items forecast in real economic forecasts decline in 2020 compared with the previous year but start to recover after 2020. Public consumption and unemployment, in turn, grow in 2020 but start to fall after that. The real economic forecast of the Ministry of Finance is generally in line with those of the other forecasters.

The forecasts of the Ministry of Finance on general government finances are in line with those of the other forecasters. General government debt and deficit grow exceptionally rapidly in 2020, but the growth will slow down in the coming years. In the forecasts on general government fiscal balance, the dispersion in 2020 is relatively high.[59]

The forecast of the Ministry of Finance is mainly in line with those of other forecasters.

The forecasts of the Ministry of Finance for 2021–2022 start to deviate from the other forecasts by presenting the most optimistic or pessimistic outlook. However, the deviations are mainly quite small, the number of forecasters is relatively small, and the difference between the minimum and maximum are relatively small. It should also be observed that the most optimistic or pessimistic forecast may ultimately prove to be closest to the truth.

The item of private consumption is the most significant demand item based on its size (52% of GDP in 2019), and therefore forecasts on it are important for aggregate demand. When the level of private consumption is examined in euro, the forecast of the Ministry of Finance is the most optimistic one for 2021 and 2022 (Figure 20). This means that the forecast of the Ministry of Finance may even be more optimistic than that of the forecasters expecting a vaccine to be available next year. In addition to the Ministry of Finance, there are 13 forecasters. When the growth rates are examined, the 4% growth forecast of the Ministry of Finance for 2021 is the fourth most optimistic together with those of Etla and Akava Works.

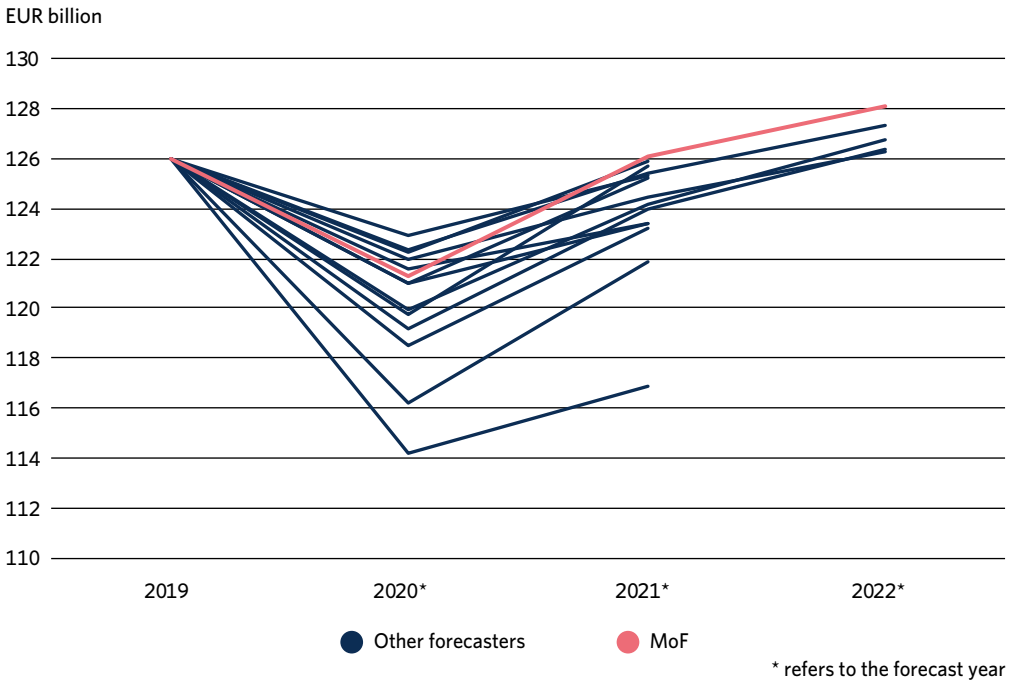

Figure 20: Forecasts on private consumption for 2020–2022, EUR million based on 2019 prices. Source: forecasters and NAOF.

The greatest deviation in euro is in the Ministry's forecast on imports, which is about EUR 1.7 billion lower for 2022 than the second lowest forecast and about EUR 3.7 billion lower than the sample average. The deviation corresponds to about 2–4 per cent of the size of the item. For 2022, there are only five forecasters in addition to the Ministry of Finance. Thus, the sample is small, and the difference between the minimum and maximum is not very wide. However, when the volume growth is examined, the forecasts on imports do not differ from the calculated minimum–maximum intervals or prediction intervals.

The Ministry of Finance forecasts that the current account deficit[60] will grow in 2021 over 2020, whereas the other forecasters expect the current account deficit to either remain unchanged or narrow in the corresponding period (Figure 21). The Ministry of Finance does not specify why it forecasts the deficit to grow. Mechanically, the reason cannot be found in the balance of goods and services, as according to the forecast, its deficit will narrow in 2021. Therefore, the reason must be in other current account sub-items, i.e the balance of factor incomes or income transfers.

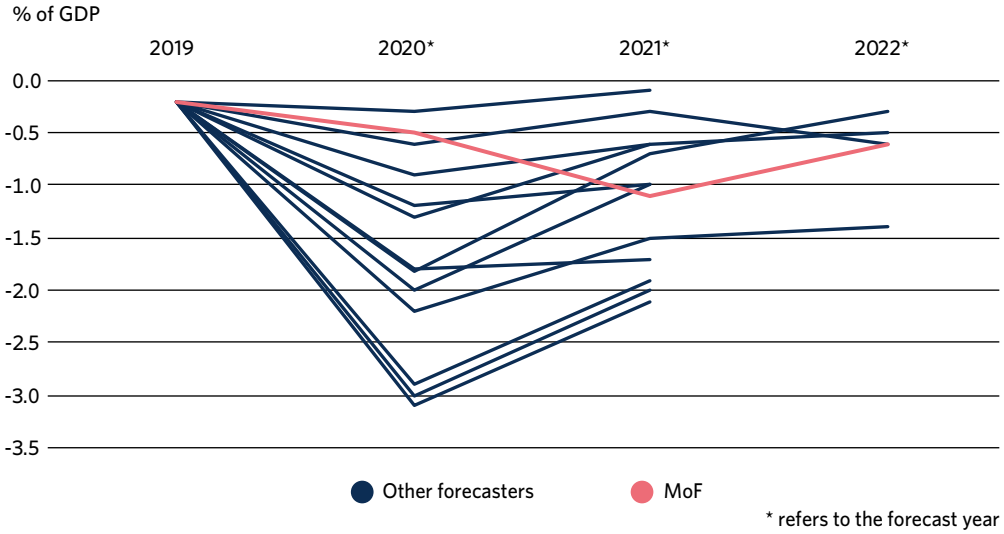

Figure 21: Forecasts on the current account for 2020–2022, % of GDP. Source: forecasters and NAOF.

Appendix 1: Methods of calculating the fiscal impacts of employment measures

This appendix describes how the National Audit Office has calculated the impacts of employment measures on general government finances. Many parts of the microeconomic-level calculations are based on the background memo of the Economic Policy Council (Seuri 2020), where the impact per a newly-employed individual is EUR 18,000 per year. As regards early childhood education, we use the figure produced by the Ministry of Finance. In the case of extending compulsory education, the calculation is based on the details set out in the background memo[61] of the Economic Policy Council. Of the estimated impacts of the activation model, only a fifth has been taken into account in the calculation, as this is the weighting of the activation model included in the pressure projection (see also endnote 42).

The static costs of the measures have been taken from the Government proposals. However, the costs of the budget proposal for 2019, in particular, have not been taken into account in the impact assessments, as the Ministry of Finance has already included them in the sustainability gap pressure projection. In the case of the assignment for the labour market organizations, we assume in our calculation that the measures do not cause any costs. The National Audit Office has not estimated the impacts of smaller measures on general government finances. Thus, their impact on public finances has not been taken into account in the calculations. Furthermore, the calculations ignore the fact the Government's new employment target for 2029 is not consistent with the debt sustainability calculation on which the sustainability roadmap is based.

The starting point of the macroeconomic-level impact assessment is that the long-term net impact of a new employed individual on public finances does not total EUR 25,000, but any costs should be deducted from the amount. In other respects, the assessments are based on the same assumptions as the microeconomic-level calculations.

Measure	Number of new employed	Cost (or increase in appropriation)	Net impact on public finances (micro-economic level)	Net impact on public finances (macro-economic level)*
Rise in the minimum age limit for the right of additional days of unemployment security from 61 to 62 (effective as from 1 January 2020)	6,500 to 7,000	-	EUR 18,000 (Seuri 2020) * 6,500–7,000 = EUR +117 million – 126 million. The reform has already been taken into account in the pressure projection, and thus it should not be included in the EUR 2 billion adjustment measures.	EUR 25,000 * 6,500–7,000 new employed would result in EUR 162.5 million – 175 million, but the reform has already been taken into account in the pressure projection, and thus it should not be included in the EUR 2 billion adjustment measures.

Measure	Number of new employed	Cost (or increase in appropriation)	Net impact on public finances (micro-economic level)	Net impact on public finances (macro-economic level)*
Nordic employment service model	9,500 to 10,000	EUR 70 million for the Employment Offices	EUR 18,000 * 9,500–10,000 new employed = EUR +171 million – 180 million. Static + dynamic impact = EUR +101 million – +110 million (based on the same assumptions as in the case of the activation model).	EUR 237.5 million – 250 million – static costs = EUR 167.5 million – 180 million
Increase in the employment rate of people aged over 55 (assignment for labour market organizations)	10,000 to 12,000	-	Assumption: The assignment results in the indicated number of the new employed. The reform does not cause any costs. EUR 18,000 * 10,000–12,000 new employed = EUR 180 million – 216 million	Corresponding assumption: EUR 25,000 * 10,000–12,000 new employed = EUR 250 million – 300 million
Reduction in the fees for early childhood education	2,500 to 3,600	EUR 70 million (static cost); about EUR 140 million (incl. dynamic costs); from the MoF's background memo	EUR −100 million (from the MoF's background memo)	EUR 62.5 million – 90 million minus EUR 70 million minus EUR 58 million – 86 million = about EUR −66 million
Extension of compulsory education	1,600	EUR 34 million – 112 million (Kuosmanen and Moisio 2014, Association of Finnish Municipalities 2014, background memo of the Economic Policy Council 2018)	EUR −11 million – −89 million in 2029 (the NAOF's calculation based on the calculation by the Economic Policy Council)	EUR 25,000 * 1,600 new employed = EUR 40 million − costs = EUR −72 million – +6 million
Linear model of partial disability pension	200	-	no estimate	no estimate
Reform of adult education allowance	200	-	no estimate	no estimate
Reform of pay subsidy	500 to 1,000	-	no estimate	no estimate
Government's (sub) total	**31,000 to 36,000**	**-**	**-**	**-**

* i.e. EUR 25,000 per new employed person minus the net costs for the measures

Other employment-related decisions (not included in the Government's entry)

Measure	Number of new employed	Cost (or increase in appropriation)	Net impact on public finances (micro-economic level)	Net impact on public finances (macro-economic level)*
Removal of the cuttings of the activation model	−5,000 to −12,000 (Source: Memo of the working group for increasing employment and shortening the duration of unemployment 2016)	Static total impact on public finances: EUR 39 million per year (Government proposal 80/2019);	Dynamic impact: EUR 18,000*(−)5-12,000 new employed = EUR −90 million – −216 million; Static + dynamic impact = EUR −129 million – −255 million. As only one fifth of the activation model has been taken into account in the pressure projection, only this part can be taken into account here: EUR −26 million – −51 million.	Dynamic impact: EUR 25,000 * (−)5-(−)12,000 new employed = EUR −125 million – −300 million + static costs (EUR 39 million) = EUR −164 million – −339 million. As only one fifth of the activation model has been taken into account in the pressure projection, only this part can be taken into account here: EUR −33 million – 68 million.
Budget proposal for 2020 (mainly increases in basic social security and tax changes)	−5,000 (Source: Parliament, Internal Information Service, Memo 20190736B)	The estimated (static) additional expenses have been taken into account in the pressure projection, i.e. they should not be taken into account here.	The dynamic impact: is 18,000 * (−)5,000 new employed = EUR −90 million. No impact is seen in the data on which the basic sustainability gap scenario is based (2010–2019).	The dynamic impact is EUR 25,000 * (−)5,000 new employed = EUR −125 million. No impact is seen in the data on which the basic sustainability gap scenario is based (2010–2019).
Total	7,500–18,600 (assuming that the targeted number of new employed people is achieved by the assignment given to the labour market organizations. The impact of the rise in the minimum age limit for the unemployment pathway to retirement has not been taken into account here, as it has already been taken into account in the pressure projection).	-	EUR −49 million – +99 million. The impact of the rise in the minimum age limit for the unemployment pathway to retirement has not been taken into account here, as it has already been taken into account in the pressure projection. A fifth of the removal of the cuttings of the activation model has been taken into account, as a corresponding share of the impact of the activation model has only been taken into account in the pressure projection.	EUR +86 million – +260 million. The impact of the rise in the minimum age limit for the unemployment pathway to retirement has not been taken into account here, as it has already been taken into account in the pressure projection. A fifth of the removal of the cuttings of the activation model has been taken into account, as a corresponding share of the impact of the activation model has only been taken into account in the pressure projection.

References

1. The fourth supplementary budget also included conventional adjustments of general government operating expenses, which are not included in the stimulus package.
2. Actual Business Finland subsidies and loans by 27 October, Finnvera by 31 October, ELY Centre by 4 October, State Treasury by 29 October, subsidies to sole entrepreneurs by 15 September, subsidies to entrepreneurs in food services by 27 October, and Tesi's support for businesses by 31 October.
3. https://www.valtiokonttori.fi/tilastot-ja-raportit/tilastoja-korvaus-ja-vahinkopalveluista/tilastoja-yritystuki/#a-da3cdaf
4. HE 25/2020 and 153/2020 vp.
5. EV 14/2020 vp.
6. EV 14/2020 vp.
7. The amount of support paid by 27 October amounted to EUR 101.98 million.
8. Helsinki GSE Situation Room. https://www.helsinkigse.fi/research-group/covid-19/
9. Actual numbers by 31 August 2020.
10. Helsinki GSE Situation Room. https://www.helsinkigse.fi/research-group/covid-19/
11. See Mäki-Fränti and Kinnunen https://www.eurojatalous.fi/fi/2016/artikkelit/pitkittynyt-taantuma-heikentaa-nuorten-sukupolvien-asemaa-suomessa/ and Roope Uusitalo http://blog.hse-econ.fi/?p=7236
12. Eurostat.
13. Coronavirus-related fiscal measures decided by September 2020 https://www.euifis.eu/download/efm.pdf
14. For the objectives included in the General Government Fiscal Plan, see the Annual Report of the National Audit Office for 2020.
15. According to the Decree: "The General Government Fiscal Plan sets multi-annual objectives for the fiscal position as a percentage of GDP at market prices for the entire general government and, in addition, a separate objective for each sub-sector of general government listed in paragraph 1. The fiscal position objectives shall be set in such a manner that, based on the forecast of the Ministry of Finance, they lead at least to the achievement of the objective set for structural general government fiscal position. Deviations from this can only be permitted if the Council of the European Union has declared, under Section 4 of the Act referred to in Section 1, that exceptional circumstances are prevailing in Finland." (Italics added.) According to the explanatory memorandum related to the Decree, this provision makes it possible to set such fiscal position objectives during exceptional circumstances that do not lead to the achievement of the structural fiscal position objective.
16. The impact of interest rate changes on government interest payments varies somewhat depending on whether the examination is based on the state's budget accounts, which have an effect on the state's borrowing need, or on statistical data on general government finances. The former are recorded with the effect of interest rate swaps, with which the state's interest rate risk is managed. The latter, in turn, are entered in statistics without the effect of interest rate swaps, whereby they illustrate the interest rates on bonds according to their original maturity.
17. In the figure, average interest rate refers to the average yield of a bond in connection with its issue.
18. Of the factors having an impact on the duration of bond purchase programmes, the ECB has explicitly stated that there is a connection between the implementation of the ECB's inflation target and the duration of the purchase programmes. Inflation forecasts for the coming years do not indicate that the ECB's inflation target would be met soon.
19. O. Blanchard, Á. Leandro and J. Zettelmeyer: Revisiting the EU fiscal framework in an era of low interest rates Draft: March 9, 2020.
20. According to them, a possible underlying factor is an increase in the growth of productivity, but this would also accelerate the growth of GDP and thereby leave the public debt ratio unchanged.
21. See Charles Goodhart & Manoj Pradhan: The great demographic reversal and what it means for the economy. 2020. LSE Business Review blog.
22. For the outlook of the funding of the earnings-based pension scheme, see Työeläkkeiden rahoitusselvitys, Eläketurvakeskuksen raportteja 05/2020 (in Finnish).
23. Danmarks Nationalbank (2020), Do equity prices reflect the ultra-low interest rate environment? Economic Memo. ECB (2018), Measuring and interpreting the cost of equity in the euro area, Economic Bulletin, June. Damodaran, Aswath (2019), Equity Risk Premiums (ERP): Determinants, Estimation and Implications – The 2019 Edition.
24. See the National Audit Office's audit report 4/2018, Contingent liabilities of general government, and the follow-up report on Contingent liabilities of general government 4/2018 by the National Audit Office, 2020.

25. The recovery instrument (Next Generation EU, NGEU) consists of several different EU financial instruments and programmes, the most important one being the Recovery and Resilience Facility.
26. COMMISSION STAFF WORKING DOCUMENT: Identifying Europe's recovery needs. 27 May 2020
27. See the following audit reports of the National Audit Office: Sustainability assessments of general government finances in the knowledge base of economic policy (16/2019) and Medium-term projections in the planning of general government finances (17/2019).
28. The changes made in October 2020 reduced the impacts of the funding model on curbing the growth of expenditure.
29. See Assessment of EU fiscal rules with a focus on the six and two-pack legislation, 2019, European Fiscal Board.
30. Calmfors, L., 2020. The case for numerical employment policy targets.
31. Sustainability of Finland's public finances. Publications of the Ministry of Finance 2020:59.
32. See the Economic Policy Council's statement on the budget proposal for 2021 to the Parliamentary Finance Committee (23 October 2020).
33. According to it, an increase of 1 percentage point in the employment rate narrows the sustainability gap by 0.3 percentage point. A total of 80,000 new employed people increases the employment rate by about 2.5 percentage points, which means that the sustainability gap would eventually shrink by 0.3*2.5=0.75 percentage points (this requires that the flexibility also applies to a situation that is further from the old balance). According to the Ministry of Finance, the sustainability gap is about 3.5% of GDP or EUR 10 billion. Thus, the potential impact of employment measures is 0.75% points / 3.5 % * EUR 10 billion, i.e. about EUR 2 billion. This means that one new employed person should strengthen public finances by EUR 25,000 on average (EUR 2 billion / 80,000 new employed people).
34. For more information, see https://www.stat.fi/tup/mikrosimulointi/index_en.html.
35. Alasalmi, J. et al. (2019). Työttömyyden laajat kustannukset yhteiskunnalle (in Finnish). Publication series of the Government's analysis, assessment and research activities 16/2019.
36. Alasalmi et al. calculate the impact of new employed people on public finances based on the assumption that the employment would last seven months a year, which corresponds to the average duration of unemployment. On the annual level, the impact would thus be EUR 12,548 * 12/7 = about EUR 21,500.
37. Seuri, A. (2020). Fiscal effects of employment growth. Background Memo, Economic Policy Council.
38. Ministry of Finance (2020). Early childhood education and related fees.
39. On the other hand, in the sustainability gap calculation, moving to employment from outside the labour force may also include the employment of pension benefit recipients.
40. Seuri, A. (2020) expands his microeconomic-level analysis with these dimensions, and the resulting impact per a new employed individual is about EUR 28,000. However, the calculation ignores the fact that the employer's (and employee's) pension contributions cause payment obligations to general government. When only indirect taxation is taken into account, the impact per a new employed person is about EUR 20,500.
41. For more information, see Seuri (2020).
42. The basic sustainability gap scenario is based on the data for 2010–2019. Thus, the impact of the rise in the age limit is not shown in the data but has been included in the scenario for the coming years. Of course, the forecast scenario can prove to be on a too low level, in which case it will be adjusted later when new data becomes available. The rise in the age limit for the right to additional days was included in the sustainability gap calculation in connection with the pension reform of 2017. This is the only employment measure that has been separately taken into account in the pressure projection. Individual measures are not taken into account or are taken into account implicitly when the underlying data window moves forward. For example, the impact of the activation model is not included in the basic scenario in full, as it was valid only in 2018 and 2019. For this reason, only a fifth of the impact of the removal of the cuttings of the activation model on public finances can be taken into account.
43. For the assessment of the impacts of employment measures on general government finances, see also audit report 9/2020, "Reconciliation of fiscal policy and employment policy", of the National Audit Office.
44. The calculation does not take into account the combined impact of the rise in the minimum and maximum age limit for the right of additional days of unemployment security, as the impact will only be seen in the longer term. In the long term, the negative impact of the rise in the maximum age limit may offset the positive impact of the rise in the minimum age limit.
45. As a suitable reference group was missing, it was impossible to make a reliable ex-post assessment of the impact of the activation model on employment. (Kyyrä et al., 2019. Aktiivimallin vaikutukset työttömiin ja TE-toimistojen toimintaan. VATT Tutkimukset 48 (in Finnish)). However, this does not mean that the model has had no impacts, and therefore the ex-ante assessment has been utilized here. It should also be taken into account that the details of the activation model were modified after the working group had prepared its memo.
46. Assumptions: The assignment results in the indicated number of new employed people. The reform does not cause any costs.
47. Assuming that the assignment results in the desired number of new employed people. The impact of the rise in the minimum age limit for the right of additional days has not been taken into account here, as it has already been included in the pressure projection.

48. The impact of the rise in the minimum age limit for the right of additional days has not been taken into account here, as it has already been included in the pressure projection. A fifth of the removal of the cuttings of the activation model has been taken into account here, as a corresponding share of the impact of the activation model has only been taken into account in the pressure projection.

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

50. The economic forecasts of the Ministry of Finance are compared with the available forecasts, i.e. those of 18 other forecasters. These forecasters are Akava Works, Danske Bank, Research Institute of the Finnish Economy (ETLA), Finnish Centre for Pensions, European Commission, Handelsbanken, International Monetary Fund (IMF), MuniFin, Nordea, OP Group, OECD, Labour Institute for Economic Research, Pellervo Economic Research (PTT), POP Bank, Mortgage Society of Finland (Hypo), Bank of Finland, Savings Bank, and Trading Economics. All of these forecasters do not produce forecasts in the same scope as the Ministry of Finance.

51. Most of the forecasters do not include a second wave of the epidemic in the basic scenario of their forecast. However, some of them present alternative scenarios by describing them either in text form or by means of graphs. The OECD, the Pellervo Economic Research, and ETLA also present alternative forecasts for selected variables.

52. The other actors that forecast the economic development in Finland and that are examined here have published their forecasts between 9 June and 13 October 2020. The forecast of the Ministry of Finance was published on 5 October 2020, and it was based on information available by 18 September 2020.

53. In its forecast (Economic Survey, http://urn.fi/URN:ISBN:978-952-367-499-8), the Ministry of Finance states as follows: "the situation will remain unclear until an effective treatment and vaccines become available. Ultimately this will happen." (p. 12) "A COVID-19 vaccine is expected to be introduced in 2021, which will constitute a positive risk in the forecast." (p. 47) "Quicker-than-expected abatement of the pandemic due to an effective vaccine is the key positive risk." (p. 31) OP also states that it considers a vaccine a positive risk but does not comment on the time of arrival of the vaccine.

54. Quarterly changes are indicated in the figure as year-on-year changes in volume.

55. The National Audit Office has calculated the GDP growth rate that the annual-level forecast of the Ministry would implicate in the third and fourth quarter of 2020 if it is assumed that the growth rate is the same in both quarters. The official forecast figures of the Ministry of Finance are indicated on an annual level.

56. A recession is defined as an economic contraction during two consecutive quarters compared with the preceding quarter. According to the quarterly national accounts published by Statistics Finland, Finland's GDP started to contract in the third quarter of 2019.

57. The confidence interval indicates the range within which GDP is forecast to be with a certain probability. The Ministry of Finance forecasts that there is an 80 per cent probability that Finland's GDP will contract by between 3 and 6 per cent this year over the previous year (p. 19). The quarterly confidence interval has been derived from the above-mentioned annual confidence interval data.

58. For example, the sample standard deviation of the GDP growth forecasts (excl. the Ministry of Finance) is 1.5% in 2020, 0.7% in 2021, and 0.3% in 2022. The same phenomenon occurs with almost all variables examined. The reason for the reduction in the deviation may be that as the forecasting horizon grows, the forecasts produced by forecasting models approach the long-term average of the forecast variable.

59. In the forecasts on general government gross debt (EDP debt) relative to GDP, the estimates for 2020 vary from 66.3 per cent to 73.6 per cent.

60. The current account depicts the effects of foreign transactions, such as the trade in goods and services, primary income and secondary income, on the national income and on the balance between savings and investments in the economy (Source: Statistics Finland, http://www.stat.fi/meta/kas/maksutase_en.html). Thus, current account deficit means that the national economy expenditure exceeds the revenue and that part of the expenditure of different economic sectors is funded in net terms from abroad.

61. Seuri, A. et al. (2018). Should the compulsory education age be raised to 18 years?

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