18 June 2021 D/189/04.04.01/2021

Fiscal policy monitoring assessment on the management of general government finances

This memorandum includes the spring 2021 assessment of the National Audit Office of Finland (NAOF) on the development and management of general government finances. It is a statutory task of the National Audit Office to monitor that general government finances are managed in compliance with the Fiscal Policy Act (869/2012) and the Decree on the General Government Fiscal Plan (120/2014) issued thereunder. The assessment takes into account the General Government Fiscal Plan for 2022–2025 and is based on calculations made by the NAOF's fiscal policy monitoring, the independent economic forecast by the Ministry of Finance, and other economic forecasts. The National Audit Office presented its previous assessment in the fiscal policy monitoring report published on 7 December 2020[1]. The NAOF will publish a more extensive fiscal policy monitoring report again in December.

The following members of the NAOF's fiscal policy monitoring team participated in the production of the contents of this assessment in spring 2021: Jasmin Grünbaum, Suvi Kangasrääsiö, Jenni Kellokumpu, Arto Kokkinen, Maarit Laatikainen, Mika Sainio, Sini Salmi, and Matthias Strifler.

Helsinki, 18 June 2021

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[1]The NAOF's separate report to Parliament: Fiscal policy monitoring report, R 21/2020 vp.

Summary of the assessment

During the Covid-19 pandemic, the ratio of government debt to GDP has risen considerably in Finland. However, when compared with the other EU countries, the increase has been moderate. The large debt taken by Finland in 2020 and 2021 have been at zero interest rate in practice, which will support public finances in the next few years. However, it is not known how long the interest rates will remain low. There is a risk that interest payments may increase. Risk reserves for export credit guarantees have decreased substantially during the Covid-19 pandemic.

Finland's economic outlook collapsed in spring 2020 as a result of the pandemic. Based on current data, the economic outlook appears to have turned positive in the second quarter of 2021. If this development continues to be strong throughout the year, Finland should move towards a more contractionary fiscal policy. This makes it possible for fiscal policy to function as well as possible as a counter-cyclical tool and support the collection of reserves in good economic times. On the other hand, should a fourth wave of the pandemic come to Finland this year and turn the economic cycle negative again, stimulus measures would be justified to support the economic cycle in 2021. Cyclical fluctuations have been marked in Finland, and fiscal policy can offset them only by counter-cyclical measures. Moreover, the decisions taken in the 2021 Government discussion on spending limits will increase expenditure, which is not in line with the current economic outlook. They contribute to an expansionary fiscal policy, which, in the light of the currently available information, appears to be ill-timed considering the economic situation.

In line with the other actors producing economic forecasts, the Ministry of Finance expects the economy to recover at the end of 2021. Households, in particular, are forecast to use their accumulated savings for private consumption when restrictions are lifted as the share of vaccinated people increases. The government debt-to-GDP ratio continues to grow, but the growth will slow down in the next few years. General government deficit relative to GDP will decline from 2020 but continue to be high. However, economic forecasts continue to be rather uncertain due to the pandemic. As other forecasters, the Ministry of Finance has assumed that the pandemic will no longer significantly restrict people's everyday lives or business life after the summer. According to the NAOF's assessment, the economic forecast of the Ministry of Finance is realistic as a whole.

The Government dispensed with the spending limits rule for the year 2020, and the return to the spending limits in 2021 involved numerous exceptions. In its 2021 discussion on spending limits, the Government raised the spending limits for 2022 and 2023 by way of derogation from the limits agreed at the beginning of the parliamentary term. Exceeding the spending limits undermines the role of the spending limits system in curbing the growth of expenditure, as it may lead to easier deviation from the spending limits in the future. Secondly, raising the level of expenditure without corresponding income decisions will drive public finances further away from balance in 2022 and 2023. The most substantial increases in appropriations underlying the raising of the spending limits include, for example, the costs of a new measure decided, increased expenditure estimates for certain reforms included in the Government Programme, and an increase in an expenditure item beyond the Government's control. There is still a risk that the change costs caused by the health and social services reform will put pressure on raising the spending limits agreed in the Government discussion on spending limits.

The general escape clause activated in spring 2020 is still in force in the EU fiscal framework. It allows Member States to deviate from the objectives set for general government finances. The escape clause also provides flexibility to the national objectives that are based on fiscal policy legislation. The objectives set for general government finances in the General Government Fiscal Plan of spring 2021 are broad but meet the requirements laid down in legislation. However, the NAOF's fiscal policy monitoring points out that, in anticipation of the establishment of wellbeing services counties, the monitoring of the limit on local government expenditure resulting from central government measures has already been abandoned, although no decisions have yet been made of the future of the expenditure limit. The General Government Fiscal Plan of spring 2021 was completed after the expiration of the time prescribed in the decree.

At present, fiscal policy is steered more by the Government's objective of stopping the growth of government debt relative to GDP than by the medium-term fiscal position objective set for general government finances. It is extremely important to succeed in stopping the growth of the debt ratio. The level of improvement of public finances that is required to stop the growth of the debt ratio has decreased significantly from the forecast of autumn 2020. Based on the roadmap, the debt ratio objective requires public finances to be improved by a total of EUR 2–2.5 billion. To achieve this, the set of measures defined in the roadmap includes not only employment measures but also, for example, increasing the productivity of public administration as well as direct fiscal consolidation. In the future, it is important to monitor the situation with the debt ratio objective on a regular basis and to prepare for substantial changes in the need to strengthen public finances. The Government should also take consolidation measures if this is necessary in view of the objective.

The Government's objective is to improve the employment rate to 75 per cent by the middle of the decade and to increase through employment measures the number of people employed by 80,000 by the end of the decade as part of the objective of stabilizing the debt ratio. According to the Ministry of Finance's preliminary estimate, the employment measures decided so far during the government term will improve public finances by approximately EUR 450 million by the end of the decade. Taking into account the adverse effects of the Government decisions on employment, NAOF's fiscal policy monitoring assesses that the overall impact of employment decisions on public finances will remain lower than this, at approximately EUR –156 to +517 million. When the employment measures decided so far are assessed in relation to the debt path presented in the sustainability roadmap, they account for approximately EUR –2 to +403 million of the targeted overall improvement (EUR 2–2.5 billion) to be achieved by different measures in order to stabilize the debt ratio.

Public debt has risen considerably during the pandemic but moderately compared with the other EU countries

The Covid-19 pandemic has had a significant impact on general government debt and deficit relative to GDP. As Figure 1 shows, it is forecast that the deficit will decrease sharply after the plunge in 2020, but the situation in the period under consideration is still forecast to remain weaker than in 2019. In the Ministry of Finance's forecast, the government debt-to-GDP ratio is expected to stabilize after a sharp increase in 2020–2021 but to continue to show a modest upward trend. In the EU Commission's forecast, it is expected to decrease slightly.

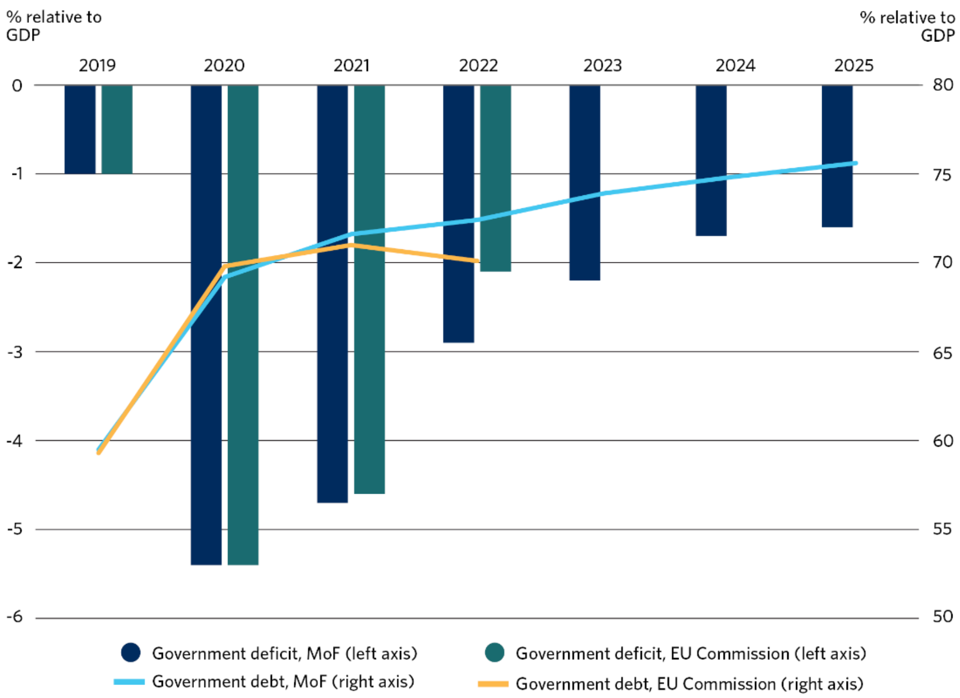

Figure 1: Government deficit and debt forecasts for 2021–2025. Sources: Ministry of Finance (MoF) and EU Commission.

Overall, Finland's general government finances have survived the Covid-19 pandemic better than average in comparison with the other Member States. Figure 2 illustrates the development of the government debt-to-GDP ratio in 2020. Finland's public debt ratio rose significantly less than average in 2020. In addition, the figure provides an indicative illustration of how much the Covid-19 crisis increased debt ratios in different countries. According to this figure as well, the development of Finland's debt ratio was relatively favourable in comparison with the other EU countries . The figure is based on statistics on actual debt ratios in 2020 and the autumn 2019 forecast of the EU Commission on the development of debt ratios. At the time of preparing the forecast, there was no knowledge of the outbreak of the Covid-19 pandemic, which was therefore not yet included in the debt forecast. Since the forecast of the debt ratio naturally involves a number of uncertainties (the actual debt ratios would have deviated from the Commission's forecast even without the pandemic), the figure must in any case be considered indicative instead of an accurate estimate.

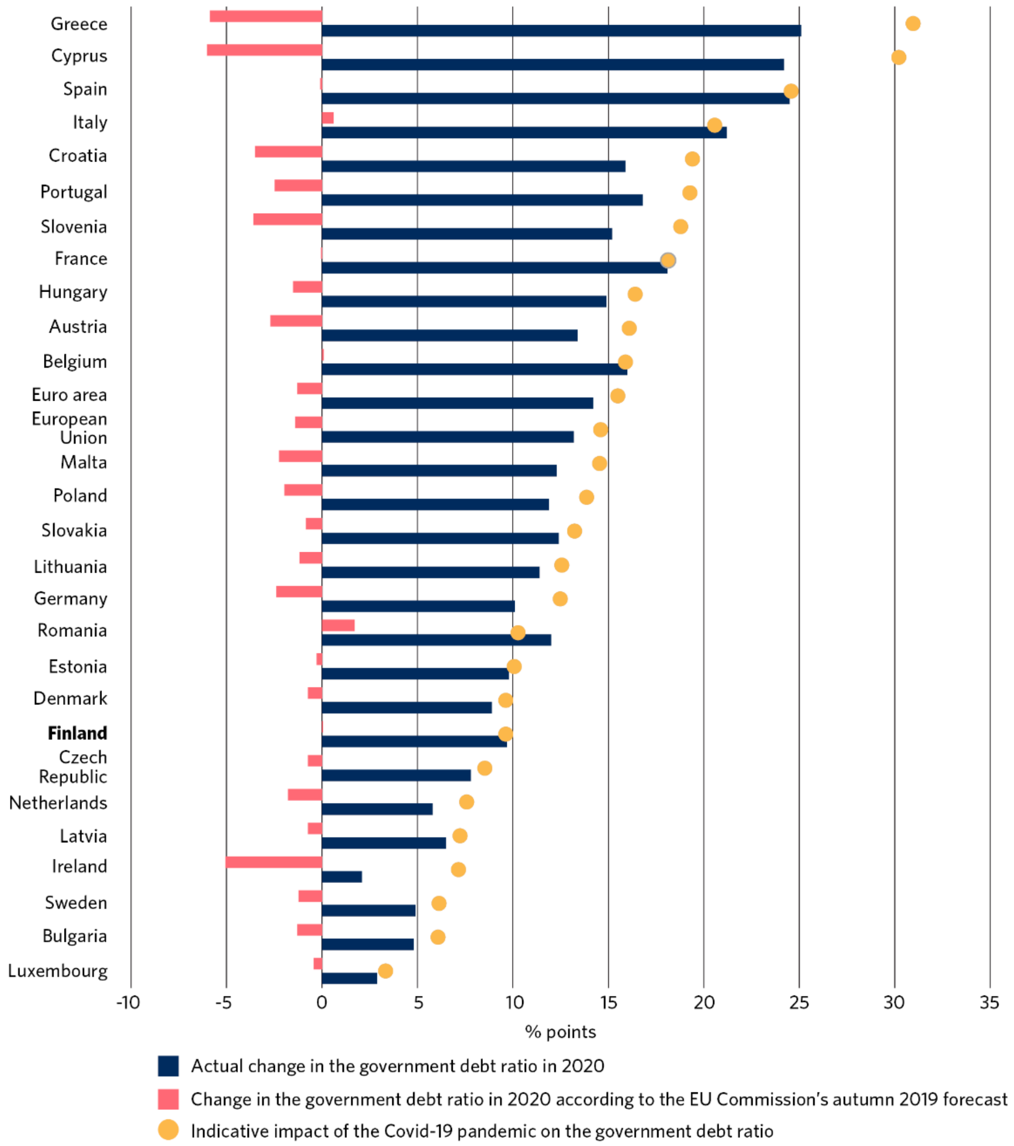

Figure 2: Actual change in the government debt-to-GDP ratio in 2020 based on statistics, the EU Commission's autumn 2019 forecast of the development of debt, and an estimate based on them of the impact of the Covid-19 pandemic on the debt ratio. Sources: EU Commission, Eurostat, NAOF.

When the development in 2020–2021 is examined on the basis of the Commission's spring 2021 forecast (Figure 3), the same conclusion can be reached on the development of Finland's general government debt ratio as in connection with the above figure concerning 2020. The development of the government debt-to-GDP ratio has been and continues to be impacted in many ways by, for example, the development of the Covid-19 pandemic in Finland and its export countries, restrictions and the reaction to them, as well as fiscal policy measures. It is very difficult to assess the exact impact of fiscal policy on this. However, the general fiscal policy approach chosen for the management of the crisis has contributed to the mitigation of economic damage.

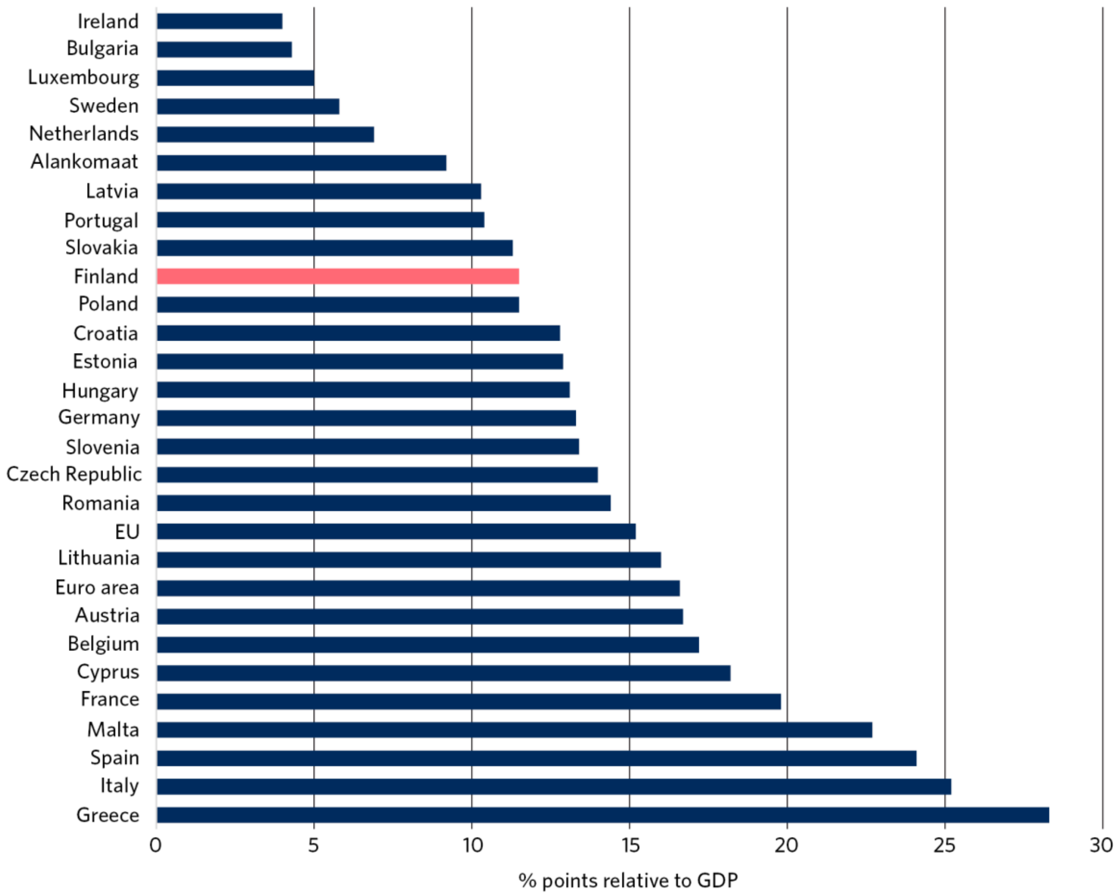

Figure 3: Growth of the government debt-to-GDP ratio in the EU countries in 2020–2021 Source: EU Commission's forecast of 12 May 2021.

The growth of government debt has not been reflected in interest expenses, but interest payments have been on the decrease. This is because recently, previously taken debt maturing now have been more expensive on average than the new debt. The average interest rate of new government debt has been falling for a long time. The extremely high gross borrowing in 2020 was implemented on average at a slightly negative, practically zero interest (Figure 4). The situation has remained unchanged in 2021 as the average interest rate of new debt has been slightly negative. This will affect the interest expenses of government debt in the next few years and provide a margin of manoeuvre in fiscal policy. However, it is unknown how long the situation will last. With a higher debt level, this poses a risk of a substantial increase in interest expenses.

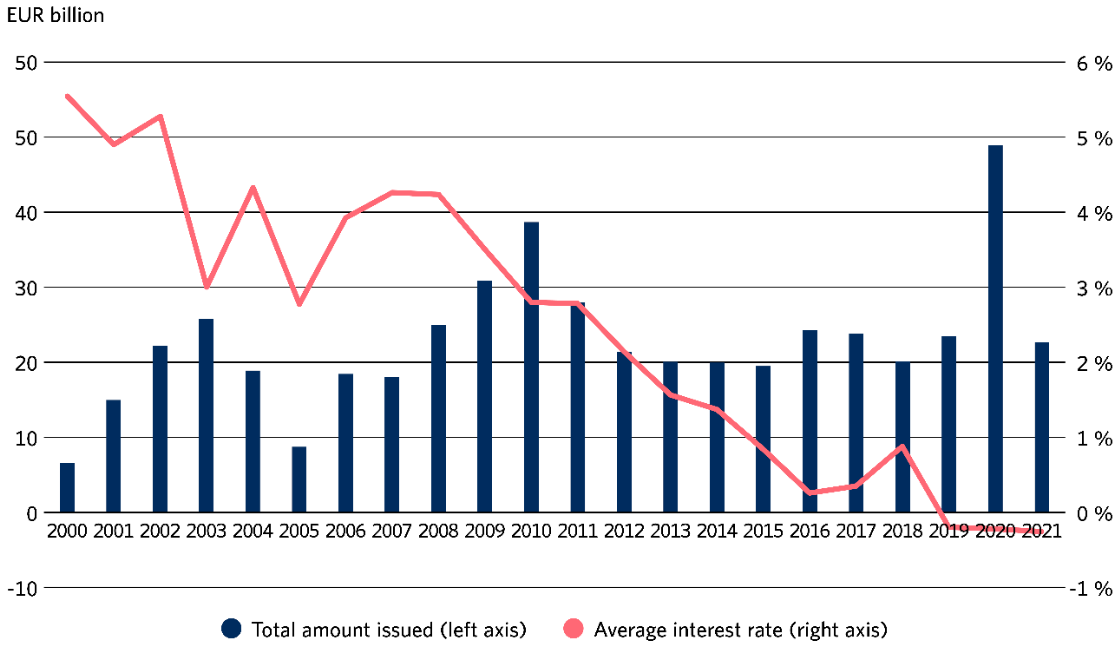

Figure 4: Government bonds issued in 2000–2021 and actual average interest rate (yield) on the issues. The average interest rate has been calculated as a weighted average based on the issues whose interest rates have been published on the website of the State Treasury. The issuing methods and maturities of the bonds vary, and therefore the interest rates shown in the figure for different years do not reflect the interest rates on bonds of equal maturity. As for 2021, the figure is based on information up until 19 May. Source: State Treasury and NAOF.

State guarantees and other contingent liabilities are not directly reflected in government debt and deficit, but it is important to examine them as they pose a risk to public finances that may be realized. The amount of state guarantees has been growing in Finland for a long time (Figure 5). During the review period, particularly export credit guarantees have been on the increase, although their growth has recently slowed down. Fiscal policy does not set any restrictions 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.[2]

The loss reserves related to the export credit guarantee and special guarantee operations of the state's specialized financing company Finnvera have decreased considerably during the Covid-19 crisis (Figure 5). As the reserves had decreased substantially, a decision was made in May to strengthen the remaining reserves in the third supplementary budget proposal for 2021, which increases the expenditure in the state budget. At the end of 2019, the accumulated loss reserves for export credit guarantee and special guarantee operations amounted to approximately EUR 1.5 billion. The severe loss of 2020 was primarily covered by the export credit guarantee and special guarantee operations fund on Finnvera's balance sheet and a fund payment of EUR 349 million from the State Guarantee Fund. After the fund payment, the reserves for export credit guarantee and special guarantee operations consist solely of the EUR 342 million remaining in the State Guarantee Fund. In the financial statements of 2020, the decrease in reserves relates to loss reserves for export credit guarantee and special guarantee operations, not to actual, paid compensations for losses.

[2]See the NAOF's observations and recommendations related to the contingent liabilities of general government in *Contingent liabilities of general government*, the NAOF's audit report 4/2018, and *Follow-up report Contingent liabilities of general government* 4/2018.

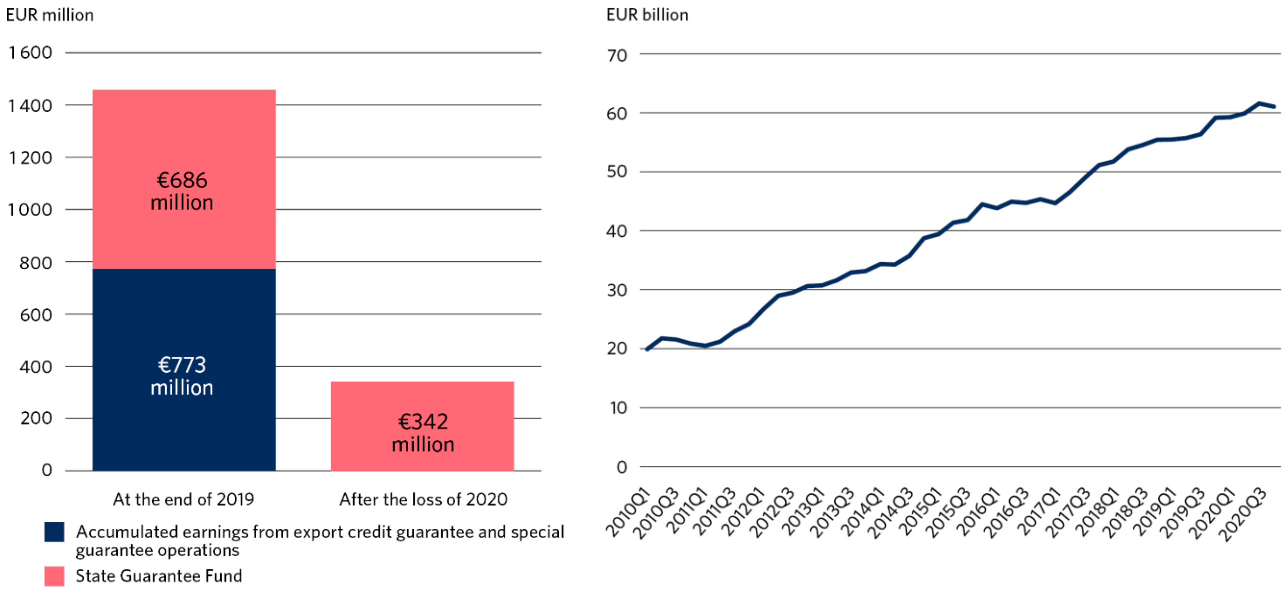

Figure 5: Development of the reserves related to Finnvera's export credit guarantee and special guarantee operations in 2020 and development of state guarantees in 2010–2020. Sources: Finnvera, Statistics Finland.

Business cycle indicator indicates strong economic recovery in spring 2021

The colour code of the business cycle heatmap produced by NAOF's fiscal policy monitoring turned red, i.e. indicated improved economic development, in April 2021 for the first time after the outbreak of the Covid-19 pandemic in Finland. The pandemic contracted the economy considerably in 2020, which was reflected in the heatmap and the related composite indicator as a historically drastic collapse.

The business cycle heatmap is a tool that describes the economic cycle in Finland by means of colour codes and monitors the development of indicators illustrating the state of the Finnish economy. The indicators have been selected on the basis that historically, they have illustrated cyclical fluctuations accurately, monthly data is available on them, and they are linked to the development of GDP.[3]

The colour of the heatmap changes according to the change in the indicator values. Red represents a situation where, based on the indicator in question, economic activity exceeds the average level, e.g. the employment rate is improving, and salaries are rising. 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.

[3]The regularly updated business cycle heatmap produced by NAOF's fiscal policy monitoring is available at the NAOF's website.

Year	Vacancies, change	Capacity utilization	Consumer price index, change	Consumer confidence	Wages and salaries, change	Services confidence	Construction confidence	Industrial confidence	Employment rate, change	Unemploy ment rate, change	Retail trade confidence	Composite indicator (weighted)
⊟ 2021												
5				1,21		0,35	-0,15	1,26			0,69	0,35
4	2,32	0,36	0,52	1,67		-0,14	0,03	0,87	0,23	1,63	0,82	0,78
3	1,02	0,18	-0,10	0,08	-0,50	-1,39	-0,48	0,18	0,23	-0,09	0,00	-0,07
2	-0,64	-0,10	-0,41	0,35	-0,26	-1,44	-0,93	-0,23	-0,14	-1,34	0,31	-0,48
1	-0,79	0,26	-0,41	0,28	-1,67	-1,27	-0,74	-0,09	-1,73	-1,52	0,04	-0,74
⊟ 2020												
12	-1,14	-0,28	-0,95	-0,49	-0,50	-1,68	-0,71	-0,38	-1,71	-1,86	0,03	-0,96
11	-1,16	-0,39	-0,95	-0,28	-1,40	-1,73	-0,63	-0,96	-0,21	-1,70	-0,30	-0,98
10	-1,55	-0,63	-0,95	-0,78	-0,43	-1,73	-0,46	-1,08	-0,43	-1,79	-0,63	-1,04
9	-1,49	-0,54	-0,95	-0,67	-0,78	-1,81	-0,45	-1,45	-0,35	-1,79	-0,53	-1,11
8	-1,60	-0,73	-0,95	-0,58	-1,88	-1,69	-0,44	-1,36	-1,57	-2,00	0,15	-1,34
7	-1,24	-0,46	-0,64	-0,06	-0,57	-1,99	-0,21	-1,07	-1,18	-2,11	-0,56	-1,05
6	-1,63	-0,51	-1,11	-0,44	-1,98	-3,27	-0,86	-1,62	-1,31	-3,20	-0,87	-1,70
5	-1,50	-0,58	-1,27	-1,60	-3,52	-3,56	-0,70	-1,62	-2,08	-4,64	-0,69	-2,20
4	-1,52	-0,44	-1,34	-2,30	-1,36	-3,41	-0,77	-1,54	-0,72	-4,52	-2,09	-1,89
3	-1,54	-0,12	-0,64	-0,96	-0,23	-1,04	0,43	-0,47	-0,65	-1,39	-1,21	-0,75
2	-0,49	0,03	-0,49	-0,44	-0,26	-0,37	0,58	-0,31	0,01	0,13	-0,68	-0,24
1	0,19	-0,02	-0,33	-0,49	0,56	0,02	0,53	-0,58	0,75	0,27	-0,35	0,02
⊟ 2019												
12	0,72	0,10	-0,41	-0,37	-0,57	0,12	0,49	-0,42	0,81	0,26	0,66	0,03
11	0,72	0,00	-0,57	-0,30	-0,13	-0,10	0,63	-0,36	-0,06	0,22	0,66	-0,05
10	0,83	0,58	-0,57	-0,78	0,39	0,01	0,81	-0,54	0,30	0,35	0,34	0,06
9	0,82	0,59	-0,41	-0,26	0,22	0,09	0,89	-0,34	0,82	0,38	0,85	0,21
8	0,74	0,86	-0,25	-0,46	0,22	0,01	0,66	0,05	-0,14	0,39	0,03	0,17
7	0,40	0,91	-0,49	-0,46	0,46	0,23	0,64	-0,11	0,50	0,46	0,10	0,21
6	0,19	0,94	-0,33	-0,55	-0,19	0,74	0,53	-0,29	-0,21	0,49	0,14	0,10
5	0,15	0,80	-0,18	-0,06	0,97	0,10	0,88	0,17	0,15	0,53	-0,08	0,29
4	0,47	1,13	0,06	0,08	0,59	0,15	0,79	-0,05	0,84	0,73	-0,05	0,41
3	1,05	1,08	-0,25	0,04	0,22	0,09	1,08	0,08	1,13	0,70	0,18	0,44
2	1,11	1,22	-0,10	0,08	0,49	0,49	1,00	0,01	0,61	0,76	0,27	0,50
1	1,05	1,27	-0,25	0,04	0,73	0,23	1,46	0,47	1,54	0,82	0,33	0,66

Figure 6: Heatmap produced by the NAOF's fiscal policy monitoring.

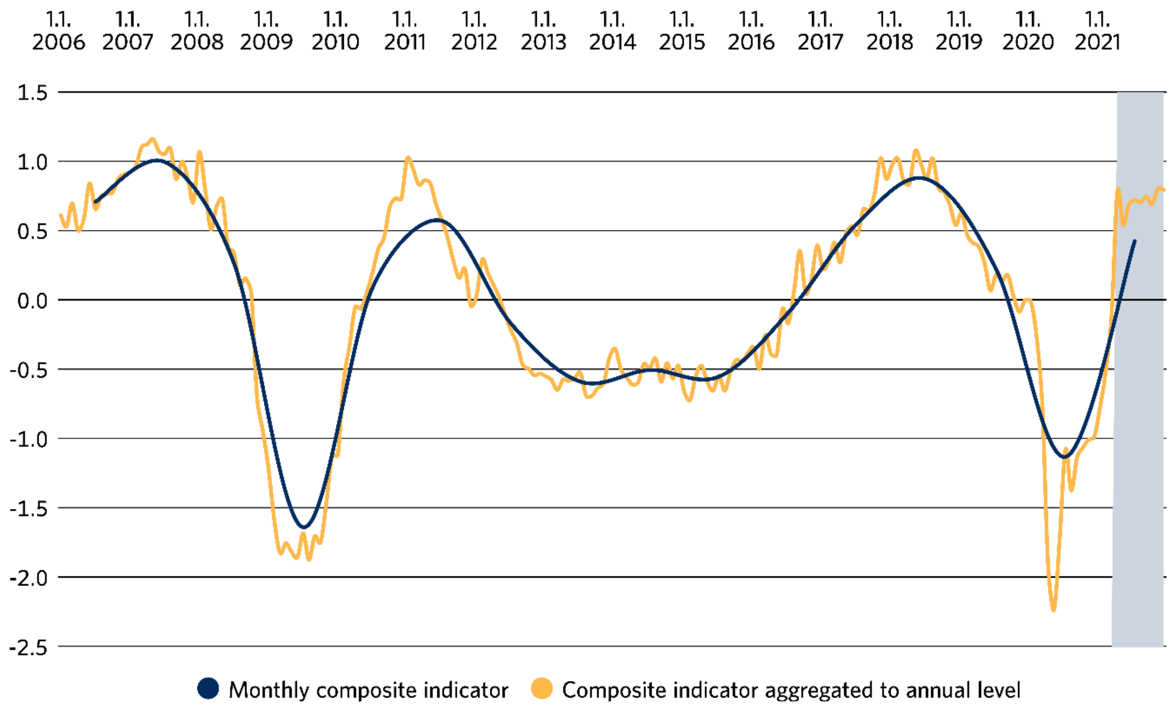

Figure 7: Composite indicator on the monthly and annual level and forecast for the current year (on grey background).

A composite indicator whose value is calculated from the heatmap variables has also been compiled of the individual cyclical indicators. Figure 7 shows the composite indicator values per month and per year. As shown in the figure, the monthly composite indicator manages to illustrate the cyclical conditions much more sensitively than the annual indicator. This is particularly evident in the observations for 2020 and the accuracy with which the indicator reacted to the Covid-19 crisis. As can be seen from the past year's development of the monthly indicator in the figure, the composite indicator was very sensitive to the sudden drop in economic activity in Finland in April 2020 and to the turnaround of the business cycle in April 2021.

Although the business cycle heatmap illustrates the development of the business cycle on a monthly level, it can not, in the middle of the year, provide a direct overview of the cyclical situation for the entire current year. Nevertheless, it is useful to have an assessment of the average cyclical situation for the entire year, as the counter-cyclicality or pro-cyclicality of fiscal policy is primarily assessed on annual level.

Therefore, NAOF's fiscal policy monitoring has developed a forecast based on the business cycle heatmap. A forecast for the current year has been made for each heatmap variable, and based on them, a forecast has been calculated for the heatmap's composite indicator for 2021. NAOF's forecast is also strongly based on forecasts of other actors, such as the Ministry of Finance, the Finnish Centre for Pensions, and Trading Economics. In this way, the NAOF aims to ensure that its forecast utilizes these forecasters' expertise as widely as possible.

In practice, the forecasts of other actors are used in the heatmap forecast in such a manner that their annual forecasts are temporally disaggregated to the forecast months of the current year. In addition, the forecast development of euro area indicators is applied to Finland's corresponding business climate indicators. Forecasts were made in this way for nine heatmap variables with a combined weight of 0.88. The NAOF drew up forecasts independently of those of other actors for only two variables; these were calculated by statistical time series analysis (combined weight 0.12).

Figure 7 also presents a forecast for the remaining months of the current year. According to the forecast, the economy will already operate at a higher level than average before the end of 2021. It should be noted that the heatmap forecast involves a similar high level of uncertainty that is typical to all economic forecasts.

In 2020, fiscal policy provided counter-cyclical stimulus; based on information on the beginning of the year, fiscal policy of 2021 seems to be pro-cyclical

In 2020, the year of the Covid-19 crisis, the Government's fiscal policy provided counter-cyclical stimulus, which means that public expenditure was increased to support the economy during the recession and to smooth cyclical fluctuations in 2020. Based on current data, the business cycle appears to have turned positive in the second quarter of 2021. If the development continues to be strong throughout the year, there is a risk that the Government's discretionary stimulus measures may accelerate the economic development pro-cyclically when the economy takes an upturn. In this case, the economy may overheat, and cyclical fluctuations may become sharper. On the other hand, should a fourth wave of the pandemic with possible virus variants occur and reach Finland this year, stimulus measures to support the economic cycle would be justified in 2021.

The fiscal policy stance is assessed by means of the change in cyclically adjusted primary balance. The change in cyclically adjusted primary balance is the change in the general government fiscal position from the previous year, excluding the impact of economic cycles. It aims to describe whether the Government's discretionary fiscal policy has functioned counter-cyclically. The official cyclical adjustment of primary balance is performed using the production function method jointly agreed by Member States and the output gap determined by means of it. However, in the case of Finland, output gap estimates revise to a significant degree. For this reason, we assess the fiscal policy stance by means of both the output gap and the composite indicator of the business cycle heatmap produced by the NAOF's fiscal policy monitoring.

Figure 8 shows the change in cyclically adjusted primary balance, describing the fiscal policy stance, and a cyclical indicator based on the output gap estimate. The figure illustrates the Government's discretionary fiscal policy in relation to the cyclical indicator produced by means of the output gap and its change. The fiscal policy of 2020 provided counter-cyclical stimulus, which was strongly influenced by the discretionary support and stimulus measures taken because of the Covid-19 crisis. Based on the preliminary output gap estimate, the fiscal policy of 2021 would be neutral – neither expansionary nor contractionary. However, in economic upturns and downturns, the real-time estimates of the production function method are highly uncertain. Particularly the output gap and primary balance estimates for 2021 in Figure 8 can still change considerably.

The estimate of the fiscal policy stance (Figure 9) based on the composite indicator of the heatmap produced by the NAOF's fiscal policy monitoring confirms the output-gap-based estimate for 2020. However, as for 2021, the conclusions differ from each other. According to the composite indicator of the heatmap and based on currently available data, the economy seems to have taken an upturn in April 2021. On annual level, the estimate of the fiscal policy stance based on the heatmap forecast for 2021 provides a similar picture in qualitative terms. If the economy continues to grow throughout the year, the fiscal policy pursued in 2021 may prove to be pro-cyclically stimulating. This is not desirable, as it would exacerbate cyclical fluctuations. In an economic upturn, a pro-cyclically stimulating fiscal policy would not contribute to collecting reserves for worse times, which would be detrimental to the strengthening of public finances.

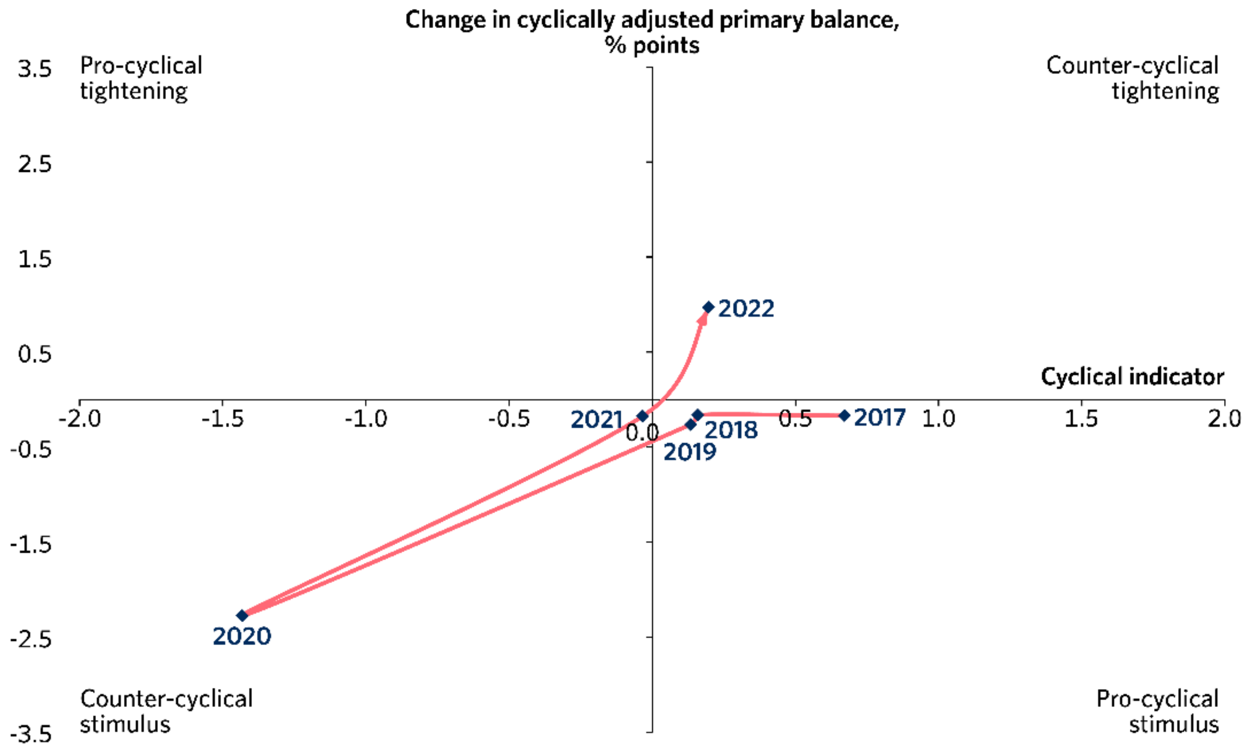

Figure 8: Fiscal policy stance relative to the business cycle: change in structural primary balance in relation to the development of a cyclical indicator based on the output gap in 2017–2022. The cyclical indicator of the figure is the average of the cyclical phase of the output gap and the change in the output gap. Estimates of both the business cycle and the change in cyclically adjusted primary balance based on the output gap method may change even significantly later on. This may also affect the conclusions made about the fiscal policy stance.

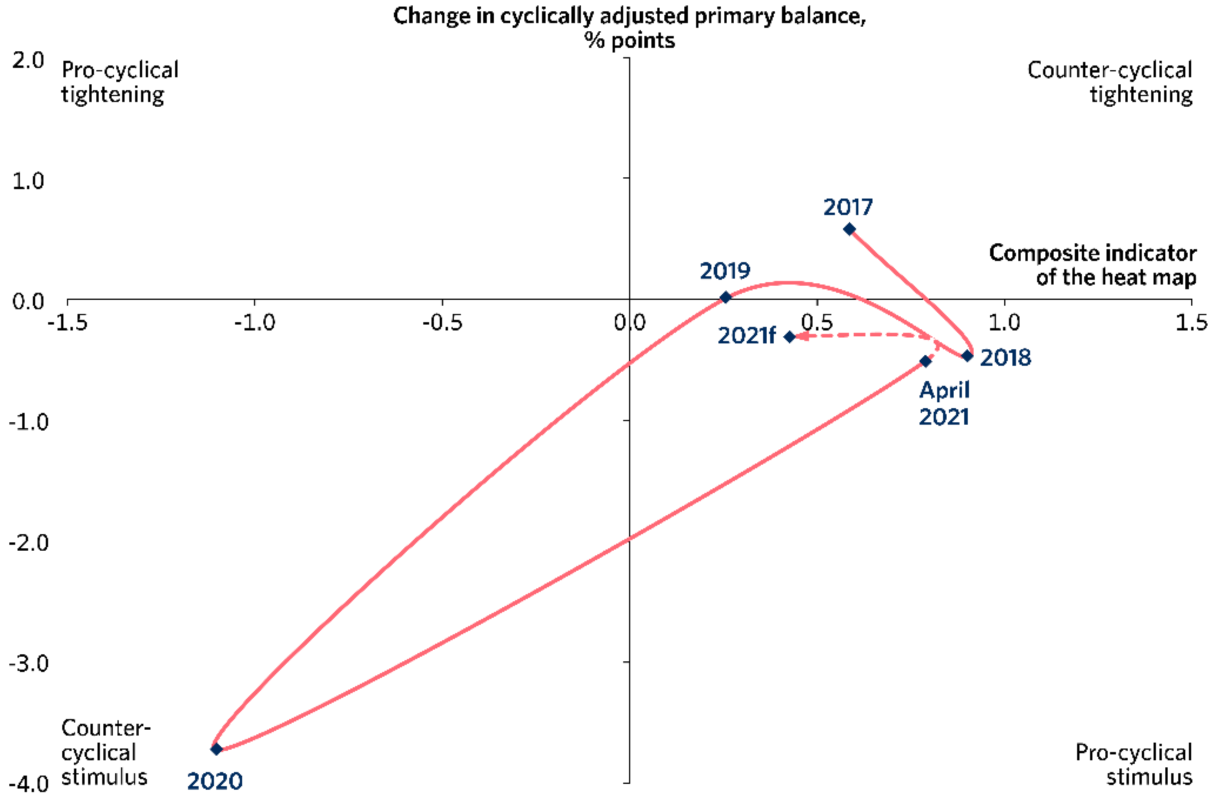

Figure 9: Fiscal policy stance in relation to the business cycle: change (cyclical adjustment by the composite indicator) in structural primary balance in relation to the development of the composite indicator produced by the NAOF's fiscal policy monitoring in 2017–2020 and in April 2021. The assessment for 2021 is based on the heatmap forecast. Based on the currently available data, the heatmap's monthly composite indicator score for April 2021 predicts that the economy will turn positive in the second quarter of 2021. On annual level, the estimate of the fiscal policy stance based on the heatmap forecast for 2021 provides a similar picture.

The economic forecast of the Ministry Finance is largely in line with those of other forecasters

Forecasters expect rapid economic growth for this and next year. As a whole, the Ministry of Finance's forecast does not differ significantly from those of other forecasters. The Ministry expects Finland's GDP to grow by 2.6% in 2021, by 2.5% in 2022, and by 1.5% in 2023. The Ministry's spring forecast for 2021 was the same as the median forecast of the forecasters of the Finnish economy[4] (2.6) but slightly lower than the mean of the forecasts (2.7). Forecasts of GDP growth in 2021 vary from 2.0% to 3.2%. The forecasts have been published during spring 2021[5].

In line with the other economic forecasters, the Ministry of Finance expects the economy to recover at the end of 2021, when household savings, in particular, are forecast to be used for private consumption as restrictions are lifted when the share of vaccinated people increases. The growth in the government debt-to-GDP ratio will slow down, and general government deficit relative to GDP will decrease towards the end of the forecasting horizon. The Ministry of Finance's forecast "is based on the assumption that the COVID-19 incidence will fall to a low level by summer 2021 as a result of

[4]The economic forecasts of the Ministry of Finance are compared with the other forecasts available, i.e. those of 16 other forecasters. These forecasters are Danske Bank, Research Institute of the Finnish Economy (ETLA), Finnish Centre for Pensions, European Commission, Handelsbanken, International Monetary Fund (IMF), MuniFin, Lähitapiola, Nordea, OP Group, Labour Institute for Economic Research, Pellervo Economic Research (PTT), 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.
[5]The other actors that forecast the economic development in Finland and that are examined here have published their forecasts between 10 January and 14 May 2021. The forecast of the Ministry of Finance was published on 12 May 2021, and it was based on information available by 30 April 2021.

restrictions, vaccinations and seasonal variation of the disease. Restrictions can be relaxed and lifted when the disease is not longer spreading[6].” The assumption is in the same lines as those of the other forecasters.

Table 1 compares the economic forecasts of the Ministry of Finance with those of the other forecasters to get an idea of whether the Ministry's forecasts are roughly in line with those of the others. Any possible deviation is examined by checking whether the Ministry of Finance's forecasts fall within three different intervals: an interval formed by picking the most optimistic and pessimistic estimates from the forecasts of the other forecasters, and two different intervals formed from the forecasts of the other forecasters. The first prediction interval is static, and the second one takes account of the publication date of the forecast. 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.

Table 1: Comparison between the forecasts of the Ministry of Finance and those of the other economic forecasters. The forecasts of the Ministry of Finance are compared with (a) the minimum–maximum interval, (b) the 95% prediction interval, and (c) the 95% prediction interval that takes account of the publication date of the forecast, formed of the forecasts of the other economic forecasters. Source: forecasters and NAOF. The scale in the table: 3 = the MoF forecast falls within all the intervals, 2 = the MoF forecast falls outside one of the intervals, 1 = the MoF forecast falls outside two intervals, 0 = the MoF forecast falls outside all of the intervals.

Forecast variable	2021f	2022f	2023f
GDP, change in volume, %	3	3	3
Imports, change in volume, %	3	3	3
Private consumption, change in volume, %	3	3	3
Public consumption, change in volume, %	3	3	2
Exports, change in volume, %	3	3	2
Investments, change in volume, %	3	3	2
Unemployment rate, % of labour force	3	3	3
Employment rate, % of population	2	2	3
Inflation, %	3	3	2
Current account, % of GDP	3	3	3
Government fiscal balance, % of GDP	3	3	2
Government gross debt, % of GDP	2	2	1

The forecast of the Ministry of Finance is largely in line with those of the other forecasters. All variables examined in the Ministry of Finance’s forecast fall within the prediction interval that takes into account the publication date of the forecast. The deviations shown in the table are due to the fact that the Ministry's forecast falls outside the minimum-maximum interval formed of the forecasts of the other forecasters. In other words, the Ministry of Finance presents the most optimistic or pessimistic forecasts. It should also be observed that the most optimistic or pessimistic forecaster may ultimately prove to be closest to the truth.

Of the variables examined, the Ministry of Finance's forecast on government debt is the only one that differs significantly from the forecasts of the other forecasters, since it exceeds the upper limit of the static 95% prediction interval in 2023. The Ministry of Finance points out[7] that, in the forecast, the debt ratio is increased particularly by the deep primary deficit of central and local government, i.e. net lending excluding gross interest expenses, and the inclusion of the fighter procurement. The deviation is probably explained by the fact that the Ministry of Finance prepared its forecast later than the other forecasters: the Ministry is the only one of the forecasters whose forecasts extend to 2023 that has taken

[6]Economic Survey, Spring 2021, of the Ministry of Finance, page 13.
[7]Economic Survey, Spring 2021, of the Ministry of Finance, page 74.

into account the decisions included in the General Government Fiscal Plan of the spring.[8] Because of the later publication date of the forecast, the Ministry of Finance has also been able to base its forecast on partly newer source data than the other forecasters for 2023. Statistics on the economic development and government debt in 2020 were published on 15 March 2021[9], and therefore the actual debt level of 2020 is higher in the Ministry of Finance's forecast than in two of the other three forecasts for 2023. The group of forecasters for 2023 is also very small, as there are three other forecasters in addition to the Ministry: the Research Institute of the Finnish Economy (ETLA), the Labour Institute for Economic Research, and Handelsbanken. The analysis made by the fiscal policy monitoring does not lead to the conclusion that the Ministry of Finance's forecast for the government debt ratio would not be realistic.

According to the medium-term projection of the Ministry of Finance, the output gap is expected to be closed by 2025. This means that output would reach its potential level in 2025. According to the NAOF's previous observations[10], the assumptions made by the Ministry of Finance regarding the closing of the output gap in the medium term have varied. The National Audit Office has been of the opinion that the Ministry should more openly justify its assumption as to the prevailing cyclical conditions, i.e. the size of the output gap, at the end of the forecasting horizon. The Ministry has not presented any justification in its forecast of spring 2021, in the General Government Fiscal Plan, or in its Economic Survey, either. The Ministry should therefore pay attention to this in the future.

The general escape clause of the EU fiscal framework remains in force – Member States may deviate from the requirements in 2021 and probably also in 2022

In March 2020, the Commission activated the general escape clause of the Stability and Growth Pact. This means that because of the crisis, Member States are allowed to deviate from the requirements set for the structural fiscal position of general government and for public spending. The escape clause activated in March 2020 continues to be in force in 2021 and also in 2022[11].

The general escape clause was created in 2011 as part of the “six pack” reform of the Stability and Growth Pact. As a result of the financial and economic crisis, the EU recognized the need to reform its fiscal framework so that Member States can stimulate their economies through fiscal policy in the event of a serious downturn affecting the whole of the EU or the euro area. As the escape clause is in the preventive arm, Member States may deviate from the adjustment path towards the Medium-Term Objective (MTO), which is assessed on the basis of structural balance and the expenditure benchmark. For Member States under the corrective arm, the escape clause makes it possible to extend the deficit and debt adjustment period. Although the activation of the escape clause does not, in principle, prevent the initiation of the Excessive Deficit Procedure (EDP), the Commission did not initiate the procedure for any Member State in spring 2020 – although, with the exception of one, the deficits of all Member States were expected to exceed the 3% limit[12]. According to the Commission’s communication of June 2021[13], EDP procedures will not be initiated in 2021, either.

[8] The other actors producing forecasts on government debt-to-GDP ratio for 2023 are the Research Institute of the Finnish Economy (ETLA) (forecast published on 15 March 2021), Handelsbanken (28 April 2021), and the Labour Institute for Economic Research (31 March 2021).

[9] https://www.stat.fi/til/jyev/2020/04/jyev_2020_04_2021-03-15_tie_001_fi.html
and https://www.stat.fi/til/vtp/2020/vtp_2020_2021-03-15_tie_001_fi.html

[10] Fiscal policy audit report: Medium-term projections in the planning of general government finances (audit report of the National Audit Office 17/2019).

[11] https://ec.europa.eu/info/sites/default/files/economy-finance/1_en_act_part1_v9.pdf (Communication from the Commission to the Council ”One year since the outbread of COVID-19: fiscal policy response”, published on 3 March 2021)

[12] https://ec.europa.eu/info/sites/default/files/economy-finance/1_en_act_part1_v9.pdf (Communication from the Commission to the Council ”One year since the outbread of COVID-19: fiscal policy response”, published on 3 March 2021) and https://ec.europa.eu/info/sites/default/files/economy-finance/ecfin_forecast_spring_2020_statist_annex_en.pdf (European Economic Forecast - Spring 2020).

[13] https://ec.europa.eu/info/system/files/com-2021-500_en.pdf (Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank, published on 2 June 2021).

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If the escape clause is deactivated in 2023, structural balance in Finland should improve by at least 0.5% in relation to GDP. According to the target path of the stability programme and the independent forecast of the Ministry of Finance, the improvement of structural balance would be in line with the required adjustment (Figure 10). However, estimates of structural balance involve considerable uncertainty – especially when the economic cycle is turning. In its current estimate of structural balance, the Ministry of Finance has estimated that in 2025 the Finnish economy will not be in a downward or upward cycle (the output gap has closed, i.e. is zero), in which case there will be no difference between structural balance and deficit (i.e. nominal fiscal position). The progress towards the medium-term objective (MTO) would also be sufficient based on the expenditure benchmark.

The Ministry of Finance forecasts that the nominal fiscal position will be –2.2% of GDP in 2023, i.e. that deficit would be below the 3% limit. On the other hand, the forecast debt ratio of 73.9% of GDP in 2023 would exceed the limit of 60% of GDP, set by the EU treaty. Exceeding the limit set for debt does not necessarily mean that the Member State has breached the debt criterion. Under EU law, the development of debt is examined by means of a “backward-looking criterion”, which examines whether debt has decreased at the required rate. As a result of the Covid-19 pandemic, central government debt has increased since 2020, and therefore the development of the debt ratio would not meet this criterion.

If the development of the debt ratio does not meet the backward-looking criterion, compliance with the debt criterion is assessed by examining the debt forecast for the next two years by means of a “forward-looking criterion”. According to the forecast, the debt ratio will continue to grow even in 2024 and 2025, which means that Finland would breach the debt criterion even based on the forward-looking criterion. As regards compliance with the debt criterion, it is also assessed whether the excess of the criterion is due to economic cycles. This is done by calculating the “cyclically adjusted debt”. The current estimate of the cyclically adjusted debt is 74.4% of GDP in 2023. Thus, Finland would also breach the debt criterion in cyclically adjusted terms – provided that the outlook for the debt ratio remains unchanged. So far, however, a mere breach of the debt criterion has not, in practice, led to the initiation of the EDP procedure. Under EU law, a number of factors shall be considered when a decision concerning the procedure is made because of a breach of the debt criterion. It shall be considered, for example, whether the Member State has complied with the preventive arm of the Stability and Growth Pact.

The debate on the reform of the EU's fiscal framework started already before the Covid-19 pandemic and has become more heated as a result of the pandemic and the rapidly growing debt of Member States. The Commission's assessment of the difficult questions and implementation challenges related to the framework was published in February 2020.[14] However, due to the Covid-19 pandemic, consultation on the reform of the framework is currently on hold. The European Fiscal Committee[15] has even considered it detrimental if the framework is returned to without that it is directly reformed when the escape clause is deactivated[16].

[14] European Commission (2020), “Economic Governance Review”, February 2020.
[15]The European Fiscal Board acts as an independent advisory body of the European Commission. The Committee was established on the basis of “The Five Presidents' Report: Completing Europe’s Economic and Monetary Union”. The aim is to strengthen economic governance.
[16] https://ec.europa.eu/info/sites/default/files/efb_annual_report_2020_en_1.pdf (Annual Report 2020 of the European Fiscal Board).

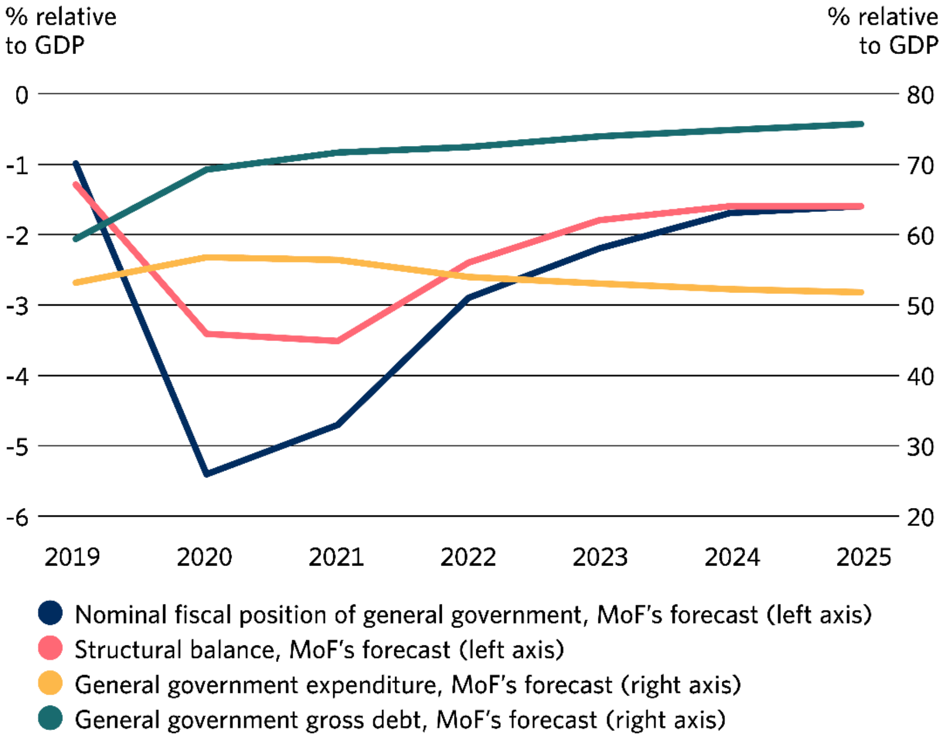

Figure 10: Nominal fiscal position of general government, structural balance, expenditure and debt relative to GDP in 2020–2025.

Exceeding the spending limits set for the parliamentary term in 2022 and 2023 undermines the credibility of the spending limits system

The central government spending limits system was dispensed with for 2020, and the Government will not return to the expenditure level decided in the Government Programme during the current parliamentary term. In the mid-term review, the Government decided to increase the spending limits for the parliamentary term by EUR 900 million for 2022 and by EUR 500 million for 2023. These decisions to raise the spending limits are not based on pandemic-related increases in expenditure. The most substantial increases in appropriations underlying the raising of the spending limits include, for example, the costs of a new measure decided (support for the electrification of energy-intensive enterprises), increased expenditure estimates for certain reforms included in the Government Programme (e.g. the ICT costs of the health and social services reform), and an increase in an expenditure item beyond the Government's control (increase in EU contributions). There is still a risk that the transition costs caused by the health and social services reform will put pressure on raising the spending limits level agreed in the mid-term review.

Several exceptions have been made to the spending limits rule, and they will also have an impact from 2021 onwards (Table 2). The direct "health security costs" (testing and vaccination) associated with Covid-19 have been transferred outside the spending limits for the years 2021–2023. In addition, Finnvera Oyj's expenditure for loss compensations and subsidies paid to SMEs were also transferred outside the spending limits (under "Impacts of exceptional circumstances" in the table below). The activation of the mechanism for exceptional circumstances in 2020 makes it possible to raise the level of spending limits by EUR 500 million in 2021 and 2022. The increases in expenditure can be allocated to one-off expenditure. In addition, outside the scope of the spending limits rule, the spending limits were raised by a provision for one-off expenditure needs that arise from the Covid-19 situation and are mandatory in terms of fiscal policy. The definition of the use of the provision is highly ambiguous, which makes it very difficult to assess the necessity of the provision in relation to other decisions taken on supplementary expenditure.

The changes made to the spending limits system from 2022 onwards substantially undermine the credibility of the entire system. In an audit report published at the same time as this report, the National Audit Office deals more extensively with the reasons why it is necessary to maintain the spending limits system as a central national fiscal policy rule and the reasons why political commitment to the system may have deteriorated. The benefits of a functioning and credible spending limits system are most obvious in difficult times when there is limited room for manoeuvre in central government finances.

Table 2: Exceptions implemented after the spending limits rule was dispensed with and their estimated impact (EUR million) in relation to the spending limits of the parliamentary term. The figure is based on information up until the third proposal for supplementary budget for 2021. Source: Ministry of Finance, NAOF.

Parliamentary term	2020	2021	2022	2023
Changes in the spending limits level: Mechanism for exceptional circumstances	-	500	500	-
Changes in the spending limits level: Provision for one-off expenditure needs that arise from the Covid-19 situation and are mandatory in terms of fiscal policy	-	1 850	-	-
Changes in the spending limits level: Rise or increase in spending limits level	(estimate EUR 6.2 billion)	-	900	500
Exceptions to the spending limits rule: Impacts of exceptional circumstances	(estimate EUR 1 billion)	415	176	155
Exceptions to the spending limits rule: Health security in the Covid-19 situation	-	1 967	50	35

Figure 11 shows how the spending limits for the parliamentary term 2020–2023, with price and structural adjustments, have changed until May 2021. Compliance with the 2020 spending limits was dispensed with in the first proposal for supplementary budget for 2020. This is reflected in the figure in that the amount of budgeted expenditure exceeds the 2020 spending limits in March 2020. The biggest increase in spending limits expenditure took place in the fourth supplementary budget for 2020.

The increase in the spending limits for 2021 between June and December 2020 was due to a new provision of EUR 500 million for additional expenditure arising from the pandemic. In the third proposal for supplementary budget for 2021, submitted in May 2021, the provision was raised by EUR 1.35 billion. The increase of EUR 1.9 billion in the level of the 2022 spending limits between February and May 2021 is due to the changes made to the 2022 spending limits during the preparation of the General Government Fiscal Plan for 2022–2025. The biggest change was raising the spending limits for 2022 by EUR 0.9 billion in accordance with the decision taken in the Government discussion on spending limits. In addition, the spending limits for 2022 were adjusted by EUR 0.8 billion in line with the cost level forecast for 2022 and raised by EUR 0.5 billion under the mechanism for exceptional circumstances. The raising of the spending limits was partly offset by a lowering of the spending limits by 0.4 billion, when part of the reserve for future-oriented investments in the 2022 spending limits were carried over to the 2023 spending limits by a change in timing. The increase of EUR 15.8 billion in the 2023 spending limits is mainly based on the EUR 14 billion structural adjustment to transfer funding to wellbeing services counties from the tax revenue and tax compensations of municipalies.

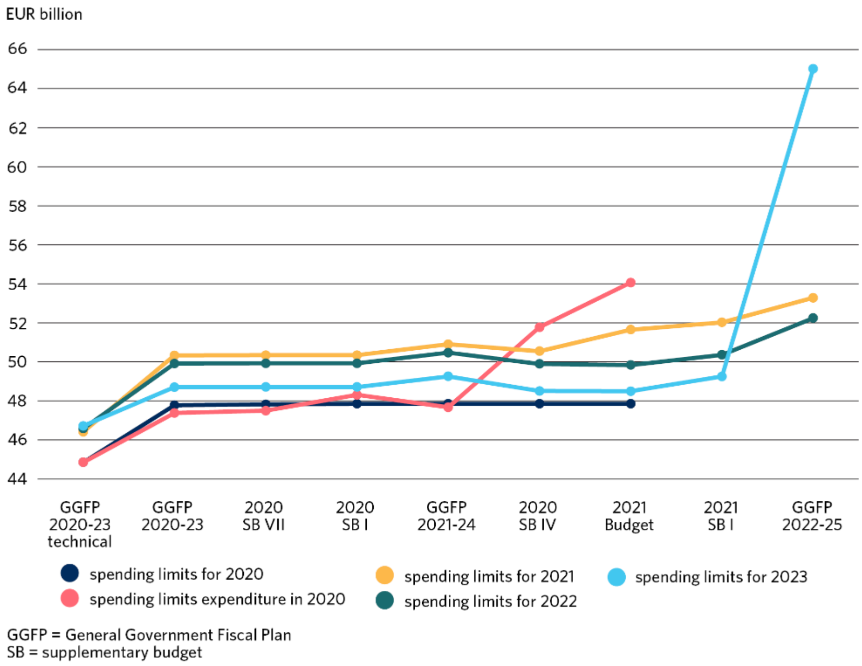

Figure 11: Preparatory phases of the spending limits for the parliamentary term 2020–2023. Source: General Government Fiscal Plans, budget and supplementary budget proposals for 2021 up until the third supplementary budget proposal, budget and supplementary budget proposals for 2020, and calculations for the Ministry of Finance and the NAOF. The spending limits for 2020 ceased to be in force starting from March 2020.

The objectives set out in the General Government Fiscal Plan are broad but meet the legislative requirements

The General Government Fiscal Plan was approved by the Government and submitted to Parliament on 12 May 2021. This does not meet the requirement set by the Decree on the General Government Fiscal Plan according to which the plan shall be updated annually by the end of April.

Appendix 1 contains the NAOF's observations on the content of the latest General Government Fiscal Plan in relation to the Decree regulating it. The latest General Government Fiscal Plan includes multi-annual objectives for the development of general government finances, which is in line with the opinions[17] expressed by the NAOF in 2020. The NAOF agrees with the Government's interpretation that, in the current situation where exceptional circumstances referred to in EU law are in force, the multi-annual and sector-specific objectives need not lead to the achievement of the medium-term objective (structural fiscal position of general government –0.5% of GDP). Thus, the escape clause brings flexibility to the tightness of the objectives. The objectives presented meet the requirement set by the decree, as the decree does not provide for tightness of the objectives in a situation where the escape clause is applied.

Compared with the target path set for public finances before the Covid-19 pandemic, the target path set now is very broad (Figure 12). It is not clear from the General Government Fiscal Plan on what basis the target path has been selected. The target path is largely in line with the development according to the independent forecast by the Ministry of Finance. Broadness of the target path means that, in the light of the independent forecast of the Ministry, no new fiscal policy measures are needed in practice to achieve it. Therefore, the medium-term objectives set for general government finances have in practice a weak steering impact for the time being. A fiscal policy objective that currently has a stronger steering impact is the objective related to stabilizing the debt ratio (see below).

[17] Fiscal policy monitoring report 2020, December 2020.
Fiscal policy monitoring assessment on the management of central government finances, May 2020.

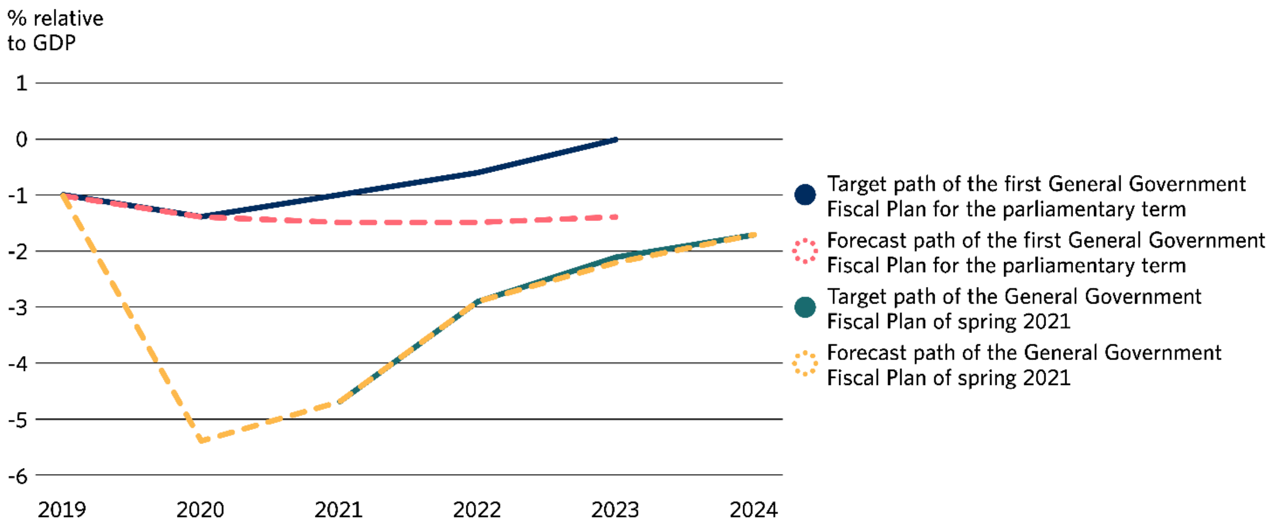

Figure 12: Target and forecast paths according to the first General Government Fiscal Plan of the parliamentary term and that of spring 2021 on the development of the nominal fiscal position of general government. Source: General Government Fiscal Plans of autumn 2019 and spring 2021.

In 2020, the National Audit Office pointed out that fiscal legislation should be developed in order to prepare for an exceptional situation similar to the one in spring 2020. At that time, no objectives were set for general government finances. The NAOF regarded the decision as justified. However, the NAOF also considered that the original purpose of the escape clause included in legislation was to provide flexibility to the tightness of objectives and not to make it possible to set no objectives at all. It is therefore good that, according to the latest General Government Fiscal Plan, it will be assessed during the year, in connection with the update of the Decree on the General Government Fiscal Plan, whether there is a need to amend the definition of exceptional circumstances in fiscal legislation.

The objective set for the nominal fiscal position of local government for 2023 is –0.5% of GDP. The Decree on the General Government Fiscal Plan stipulates that the Government shall set a limit in euros to the amount that local government expenditure can increase due to central government measures. This limit is referred to as the expenditure limit for local government finances. This limit must be in line with the objective set for the fiscal position of local government. The General Government Fiscal Plan for 2021–2024, drawn up in spring 2020, stated that the expenditure limit set in autumn 2019 had been exceeded. In the General Government Fiscal Plan for 2022–2025, the expenditure limit set for local government finances is no longer monitored, but it is stated that "Due to the establishment of wellbeing services counties, it is no longer sensible to monitor the expenditure limit in 2023". As a result of the establishment of wellbeing services counties, healthcare and social welfare tasks will be transferred from municipalities to be organized by the counties and funded by the state. Nevertheless, the valid decree requires that the expenditure limit set for local government is monitored. This applies even if the measures taken by central government had no material impact in practice on the fiscal position, as central government transfers to local government will cover 100% of the costs for the new and expanding tasks. In addition, the Government decided in the mid-term review to continue preparations for the transfer of public employment and business services to municipalities in 2024. This is to be implemented by increasing the local government's responsibility for the costs of the basic part of unemployment security in the funding model of the system. The planned transfer of tasks and increase in financial responsibility are in contradiction with the decision to stop monitoring the expenditure limit set for local government.

Improved economic outlook brought the objective in the sustainability roadmap closer

In 2020, the sustainability roadmap became 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 decided that its objective was to stabilize the government debt-to-GDP ratio by the end of the decade. The National Audit Office considers the Government's objective justified. The amount of government debt has increased, which highlights the risk that when the debt falls due, it will be replaced with new debt at a substantially 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 at least stabilize the government debt-to-GDP ratio.

In the budget session of September 2020, the Government specified the measures for improving the sustainability of general government finances. The Government declared then that it would make further specifications in its spending limits discussion of 2021. In spring 2021, the sustainability roadmap of general government finances was integrated into a wider package, including social and ecological sustainability, which is consistent with the Government Programme. It is also justified that the Government plans to review the roadmap in connection with its spending limits discussion, where it will in any case discuss the public finances of the coming years. However, some of the objectives included in the roadmap, such as the progress of employment measures, should also be monitored in connection with budget sessions to ensure that progress towards them continues.

According to the spring 2021 General Government Fiscal Plan, the Government aims to stop the growth of the government debt ratio by the middle of the decade. The basic premises of the sustainability roadmap have changed somewhat since autumn 2020. In autumn 2020, it was estimated that stabilization of the debt ratio in the 2020s would require public finances to be improved by EUR 5 billion. Now, according to the roadmap, an improvement of EUR 2–2.5 billion would be sufficient to stabilize the debt ratio and turn it to a slight decline in 2025. The National Audit Office considers such development of the debt ratio to be a justified objective. It would contribute to achieving a situation where the debt ratio can be clearly reduced during an economic upturn and where it is allowed to increase only during a downturn for stimulus measures. 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.

As the need to strengthen public finances has diminished, the objective of the sustainability roadmap is much closer than before. This is mainly due to the improvement in the medium-term outlook for public finances. The estimate of structural balance relative to GDP, i.e. deficit excluding the impact of economic cycles, has improved as forecasts for the development of employment and total output have improved.

In line with the opinions expressed by the NAOF in 2020[18], the sustainability roadmap now contains sensitivity analyses of the development of the debt ratio. This is useful because sensitivity analyses reflect, on the one hand, the dependence of the debt ratio on background factors, many of which can be influenced by fiscal policy, and, on the other hand, the inherent uncertainty of debt scenarios. In addition, the sustainability roadmap of spring 2021 presents different alternatives for the combined effects of different measures on the development of the debt ratio (e.g. increased R&D investments combined with a stronger improvement than in the basic option). This reflects well the fact that there are alternatives in fiscal policy even if the basic premise is to stabilize the debt ratio or to turn it to a downward path.

The sustainability roadmap has become somewhat more concrete. However, the number of measures whose impacts could be assessed reliably has not increased significantly. The contents of the sustainability roadmap and the measures to strengthen public finances still remain indicative. The indicative nature of the measures is illustrated, for example, by the fact that the estimated magnitude of the measures significantly exceeds the EUR 2–2.5 billion improvement needed to stabilize the debt ratio.

The list of measures also includes direct revenue and expenditure consolidation. No specific magnitude has been defined for this item, but from its formulation[19] it can be concluded that, in its nature, it is a residual that becomes necessary if the structural measures listed in the table do not lead to the desired effects. Taking into account the current (lower) estimate of the need for improvement and the fact the measures include direct consolidation, the sustainability roadmap is now more realistic than before although the structural measures are incomplete and of a general nature. In the future, the roadmap should include a clearer assessment of the concrete plans or decisions existing to stabilize the

[18] Fiscal policy monitoring assessment of 20 May 2020, Fiscal policy monitoring report of 7 December 2020
[19] "Other measures to strengthen public finances. If necessary, for example, measures that immediately reduce general government expenditure or increase revenue."

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debt ratio (or to achieve a downward trend) and an assessment of the further measures needed. At the same time, it is important to prepare for the fact that the need to strengthen public finances may continue to change substantially, in either direction.

The impact of employment measures on public finances is still far below the objective set by the sustainability roadmap

The Government's objective is to improve the employment rate to 75 per cent by the middle of the decade and to increase the number of employed people by 80,000 by the end of the decade as part of the objective of stabilizing the debt ratio. To achieve the employment rate target, the Government decided in its mid-term review on measures with an employment potential of 40,000–44,500 new employed people. These measures include, for example, the transfer of employment and business services to municipalities and, in connection with the transfer, the creation of a funding model that encourages municipalities to develop their activities to promote employment, the expansion of the work capacity programme, the reform of pay subsidies, and the reform of continuous learning. The estimated potential number of new employed is based on a joint assessment by the ministry or ministries responsible for preparing the measure (Table 3).

Table 3: Impact of the Government's employment measures on public finances.

Sets of measures	(A) Impact assessment of the number of new employed (MoF, other ministries, other actors)	(B) Estimated potential number of new employed (ministry responsible for preparing the measure)	Net impact on public finances (based on the impact assessment of new employed (A), MoF), EUR million	Net impact on public finances (based on the impact assessment of new employed, NAOF), EUR million
Decisions taken in the 2021 Government discussion on spending limits	11,000	40,000 – 44,500	150	119 – 165
Decisions taken in 2020 (budget session and others)	31,000 – 33,000	31,000 – 33,000	300	189 – 518
Other employment-related decisions (not included in the Government's list of measures)	−17,000 – −7,500	–	–	−464 – −166
Total: Excluding negative decisions	42,000 – 44,000	71,000 – 77,500	450	**+308 – +683**
Total: Including negative decisions, direct	25,000 – 36,500	–	–	**−156 – +517**
Total: Sustainability gap pressure projection as benchmark	27,600 – 32,000	–	–	**−2 – +403**

In addition to employment potentials or scenario calculations, it is important to assess the actual employment impact of the measures and their impact on public finances. According to the preliminary estimates included in the Ministry of Finance's memorandum[20], the measures will result in approximately 11,000 new employed people, and the Ministry estimates that the measures will strengthen public finances by approximately EUR 150 million by the end of the decade. The Government has already before decided on employment measures that the Ministry of Finance has estimated to bring approximately 31,000–33,000 new employed people and strengthen public finances by approximately EUR 300 million. The Ministry of Finance estimates that the employment measures so far decided will improve public finances by approximately EUR 450 million by the end of the decade. In addition, in the mid-term review, the Government outlined that by the end of the government term, it would take decisions on additional employment measures that will improve public finances by EUR 110 million.

It is good that the Ministry of Finance has now published a preliminary estimate of the impact of employment measures on public finances. The NAOF's fiscal policy monitoring has roughly assessed the fiscal impact of the measures on public finances in the same way as in its December 2020 report (Table 3).[21] As regards the decisions taken in the spring 2021 government discussion on spending limits, the NAOF's calculation does not take into account any scenario calculations of the sectoral ministries or calculations illustrating the employment potential.

However, in order to get an overall picture of the impact of employment measures on public finances, the assessment should also take into account the impact of those decisions taken during the government term that have adverse impacts on employment. Considering the adverse impacts that the dismantling of the activation model and the measures included in the 2020 budget have on employment, the NAOF's fiscal policy monitoring estimates that the overall impact of the employment decisions taken on public finances is approximately EUR −156 to +517 million.

When assessing the decided employment measures in relation to the development path presented for debt in the sustainability roadmap, it should be noted that the rise in the minimum age for additional days of earnings-related unemployment allowance and a fifth of the activation model have already been taken into account in the general government sustainability gap assessment. In view of this, the share of the decided employment measures remains at about EUR −2 to +403 million of the EUR 2 to 2.5 billion that the sustainability roadmap sets as an objective for the improvement of public finances to be achieved by different measures in order to stabilize the debt ratio. The sustainability roadmap estimates the impact of employment measures on public finances to be EUR 1 –2 billion.

[20]Ministry of Finance 2021: 2021 mid-term review. Employment measures and general government finances.
[21]For detailed information on the calculation methods, see Appendix 2.

Appendix 1: Observations on compliance of the General Government Fiscal Plan 2022–2025 with the requirements set by the Decree on the General Government Fiscal Plan.

Requirement set by the Decree	Estimate of compliance
The plan is reviewed annually by the end of April.	In 2021, the General Government Fiscal Plan was approved and published on 12 May 2021, which is not in compliance with the requirement set by the Decree.
The General Government Fiscal Plan shall cover all parts of general government finances. The plan contains sections on central government finances, local government finances, statutory employment pension institutions, and other social security funds.	The coverage and structure of the plan comply with the requirements. The plan also anticipates the establishment of wellbeing services counties and presents information on them.
The General Government Fiscal Plan sets multi-annual objectives for general government as a whole regarding the ratio of fiscal position to GDP and, in addition, separate targets for the different sub-sectors of general government. 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, by virtue of Section 4 of the Fiscal Policy Act, that exceptional circumstances are prevailing in Finland.	The Government has set objectives for fiscal position in relation to GDP until the end of the government term, i.e. until 2023, (sub-sectors of general government) and a multi-annual target path until 2024 (general government as a whole). The objectives set for the sub-sectors of general government for 2023 have been expressed at a different level of precision than the objectives set for general government as a whole. Given the differences in the level of precision, the objectives set for the sub-sectors correspond to the objective set for general government as a whole. Taking into account the cyclical conditions, the objective set for nominal fiscal position for 2023 (−2.1% of GDP) would not lead to the achievement of the objective set for structural fiscal position (−0.5 percentage points of GDP). However, as exceptional circumstances referred to in legislation are in force, the targets have been set in accordance with the decree.
In the section on local government finances in the General Government Fiscal Plan, a limit in euros is set to the change in local government expenditure due to central government measures. This limit is in compliance with the objective set for the fiscal position of local government.	The objective set for the nominal fiscal position of local government for 2023 is –0.5% of GDP. In the autumn of 2019, the Government set the expenditure limit for local government in such a manner that the measures it takes will not increase the operating expenditure of local government in 2023 by more than EUR 520 million in net terms compared with the spring 2019 technical General Government Fiscal Plan. The General Government Fiscal Plan for 2021–2024, drawn up in spring 2020, stated that the expenditure limit had been exceeded. In the General Government Fiscal Plan for 2022–2025, the expenditure limit set for local government finances is no longer monitored, but it is stated that “Due to the establishment of wellbeing services counties, it will no longer be sensible to monitor the expenditure limit in 2023”. Nevertheless, the valid decree requires that the expenditure limit set for local government is monitored.

Requirement set by the Decree	Estimate of compliance
The General Government Fiscal Plan sets multi-annual targets for general government debt and general government expenditure relative to GDP at market prices. These targets are in line with the targets set for the fiscal position of general government as a whole.	The multi-annual targets set for general government debt and expenditure relative to GDP have been expressed in accordance with the decree.
The General Government Fiscal Plan presents estimates of the key revenue and expenditure items of general government and its sub-sectors (as referred to in section 3, item 1). The estimates are drawn up on the assumption that the legislation affecting revenue and expenditure is not amended and on the assumption that the legislation affecting revenue and expenditure is amended as specified by the Government. The plan describes the impact of both options on the medium-term structural fiscal position and long-term sustainability of general government finances.	The estimates of the key revenue and expenditure items are presented for general government in total and separately for central government, local government, wellbeing services counties, employment pension institutions, and other social security funds. The plan does not set out information according to the two options as laid down in the decree. However, the plan provides detailed information on the measures to be taken in 2022–2025 that have an impact on public revenue and expenditure. In addition, the plan sets out the combined effect of the decisions taken during the parliamentary term on public revenue and expenditure by sub-sector. The target path outlined in the plan corresponds almost entirely to that of the independent forecast of the Ministry of Finance. The stability programme presents a target path. The information the plan provides on revenue and expenditure if the policy remains unchanged (Table 23) includes information according to the independent forecast. The relationship between the different paths (independent forecast, target path, unchanged policy path) has not been discussed in the plan.
The General Government Fiscal Plan specifies the measures required for achieving the fiscal position targets and their estimated financial impact.	The fiscal policy targets set out in the General Government Fiscal Plan correspond in practice to the development path of the independent forecast of the Ministry of Finance. Based on this, there is thus no need to take further measures in order to achieve the targets.
The General Government Fiscal Plan presents a comparison between the most recent macroeconomic forecasts of the Ministry of Finance and the European Commission and the budgetary forecast, and explains any significant differences between the assumptions on which the forecasts are based.	Appendix 5 presents a comparison between the latest forecasts of the Ministry of Finance and the Commission for six variables.
The General Government Fiscal Plan presents the impact of various growth and interest rate assumptions on the macroeconomic forecast and the budgetary forecast, as well as on the key figures related to general government finances.	Appendix 4 presents sensitivity analyses on the effect of different growth and interest rate assumptions.
The general government units that are not part of regular budgets at the sub-sector level shall be listed and published in connection with the General Government Fiscal Plan. The plan describes the combined impact of these units on general government fiscal position and debt.	In accordance with the decree, the plan contains a reference to the list maintained by Statistics Finland. The combined effect of these units on the financial position and debt has been presented. Thus, the requirement of the decree is met although the presentation of information at this highly aggregated level does not significantly increase transparency.

Requirement set by the Decree	Estimate of compliance
When preparing its economic forecasts, the Ministry of Finance shall take into consideration the NAOF’s conclusions on the macroeconomic forecast and the budgetary forecast. If, according to the conclusions, the macroeconomic forecasts have included a bias that has had a major impact on the forecasts during four consecutive years, the Ministry of Finance shall publish the actions taken to correct the bias or issue a public statement insofar as it does not concur with the NAOF’s conclusions.	The NAOF has not detected a bias as referred to in the decree in the Ministry of Finance's macroeconomic forecasts.

Appendix 2: Methods of calculating the fiscal impacts of employment measures

The impacts of employment measures on general government finances have been calculated as described in greater detail in Fiscal policy monitoring report 2020 R 21/2020 vp (Table 4). The calculations are largely based on the background memo of the Economic Policy Council (Seuri 2020[22]) and the sensitivity analysis of the Ministry of Finance's sustainability gap calculation. One new employed person has been assumed to have an impact of EUR 18,000–25,000 per year on general government finances. The potential costs of the measure have been deducted from this impact, depending on what the Government and ministries have published in various background calculations and protocols, or in a government proposal, or what the Information Service of Parliament has published in its background memo.

As regards the decisions taken in the Government discussion on spending limits, the calculation is based on the Ministry of Finance's employment impact assessment of the so-called incentive funding model reform, planned to be implemented in connection with the transfer of employment and business services to municipalities. The Ministry of Finance has not published a background calculation of the estimated impacts of other measures on public finances[23]. Sectoral ministries' calculations that are of scenario-like nature or that illustrate the employment potential have not been taken into account.

There are a few issues that need to be taken into account in the aggregation of the fiscal impacts of the measures. For reasons of transparency and comparability, the memo presents three different methods of summing up the impacts of the measures. The first method ignores the impacts of the Government decisions with negative effects on employment. The second method takes into account the impacts of the decisions that have either a positive or a negative effect on employment. The third method is based on the sustainability gap assessment underlying the sustainability roadmap for stabilizing the debt ratio. The sustainability gap estimate has already taken into account the raising of the minimum age for additional days of earnings-related unemployment allowance as well as a fifth of the activation model (since the dismantling of the activation model has not yet been taken into account in the sustainability gap estimate). This means that the following must be deducted from the estimated number of new employed: 6,500–7,000 (raising of the minimum age) and 1/5*(2,050–12,000) = 410–2,400 (one fifth of the activation model), as well as the measures having an adverse effect on employment that were included in the budget for 2020 and their impact on public finances. This third calculation method is compatible with the sustainability gap estimate and the sustainability roadmap.

[22] Seuri, A. (2020). Fiscal effects of employment growth. Background Memo, Economic Policy Council.

[23] The Ministry of Finance has published a memorandum entitled "Mid-term review 2021: employment measures and public finances". However, the memorandum does not explain how the impact of public finances has been assessed with regard to the following measures: The expansion of the work capacity programme, Unlocking the full potential of work-related immigration, and The reform of continuous learning applies to the entire population.

Table 4: The impact of the Government's employment measures on public finances by measure.

Decisions taken in the 2021 Government discussion on spending limits

Measure	(A) Impact assessment of the number of new employed (MoF, other ministries, other actors)	(B) Estimated potential number of new employed (ministry responsible for preparing the measure)	Net impact on public finances (based on the impact assessment of new employed (AS), MoF), EUR million	Net impact on public finances (based on MoF's impact assessment of new employed, NAOF), EUR million
Subtotal	**11,000**	**40,000–44,500**	**150**	**119–165**
Välittäjä Oy	1,000	1,000 (MoF)	0	could not be estimated
Transfer of employment and business services to municipalities (includes the incentive model for municipalities)	6,600	7,000–10,000 (MEAE)	150	119–165
Work capacity programme and pay subsidies	600	5,500–6,500 (MSAH, TEM)	14 (gross)	could not be estimated
Work-based immigration	1,500	10,000 (MEAE)	14 (gross)	could not be estimated
Reform of continuous learning	1,000	10,000–10,500 (MoEC)	23 (gross)	could not be estimated
Prevention of disability pensions and sickness absences	-	2,500 (MSAH)	-	-
Accelerating procurement	-	2,000 (MEAE)	-	-
Integration	-	2,000 (MEAE)	-	-

Decisions taken in 2020 (budget session and others)

Measure	(A) Impact assessment of the number of new employed (MoF, other ministries, other actors)	(B) Estimated potential number of new employed (ministry responsible for preparing the measure)	Net impact on public finances (based on the impact assessment of new employed (AS), MoF), EUR million	Net impact on public finances (based on MoF's impact assessment of new employed, NAOF), EUR million
Subtotal	**31,000–33,000**	**31,000–33,000**	**300**	**189–518**
Employment package for people aged over 55, 17 December 2020 (e.g. removal of the right of additional days of earnings-related unemployment allowance)	10,300 (8,900)	-	165 (190)	160–223 (only the removal of additional days, no other estimates made)

Measure	(A) Impact assessment of the number of new employed (MoF, other ministries, other actors)	(B) Estimated potential number of new employed (ministry responsible for preparing the measure)	Net impact on public finances (based on the impact assessment of new employed (AS), MoF), EUR million	Net impact on public finances (based on MoF's impact assessment of new employed, NAOF), EUR million
Rise in the minimum age limit for the right of additional days of earnings-related unemployment allowance from 61 to 62 (effective as from 1 January 2020)	6,500–7,000	-	-	117–175
Nordic employment service model	9,500–10,000	-	-	101–180
Reduction in the fees for early childhood education	2,500–3,600	-	–100	–100 – –66
Extension of compulsory education	1,600 (long-term impact on employment 13,500–15,000)	-	-	–89 – +6
Linear model of partial disability pension	200	-	-	no estimate
Reform of adult education allowance	200	-	-	no estimate
Reform of pay subsidies	500–1,000	-	-	no estimate

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

Measure	(A) Impact assessment of the number of new employed (MoF, other ministries, other actors)	(B) Estimated potential number of new employed (ministry responsible for preparing the measure)	Net impact on public finances (based on the impact assessment of new employed (AS), MoF), EUR million	Net impact on public finances (based on MoF's impact assessment of new employed, NAOF), EUR million
Subtotal	**–17,000 – –7,500**	**-**	**-**	**–464 – –166**
Removal of the cuttings of the activation model	–12,000 – –2,050 (working group memo and Economic Policy Council)	-	-	–339 – –76
Budget proposal for 2020 (mainly increases in basic social security and tax changes)	–5,000 (Parliament)	-	-	–125 – –90

Total

Excluding negative decisions	**42,000–44,000**	**71,000–77,500**	**450**	**+308 – +683**
Includes negative decisions, direct	**25,000–36,500**	-	-	**−156 – +517**
Sustainability gap pressure projection as benchmark	**27,600–32,000**	-	-	**−2 – +403**

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