Separate report of the National Audit Office to Parliament: Fiscal policy monitoring report
2021

NATIONAL AUDIT OFFICE´S REPORTS TO PARLIAMENT

R 22/2021 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 institution 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). By monitoring fiscal policy, the National Audit Office promotes the transparency and intelligibility of 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 2021 parliamentary session.

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Main content

Public finances are recovering slightly faster than previously anticipated from the slump caused by the Covid-19 crisis. The ratio of government debt to GDP has risen considerably in Finland during the pandemic. However, when compared with the other EU countries, the increase has been moderate. The large debt taken by Finland in 2020 and 2021 has 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.

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. According to the business cycle indicator of the NAOF's fiscal policy monitoring, the economy has recovered almost as rapidly this year as it collapsed in the previous year. On the basis of the forecast of the business cycle indicator, the highest cyclical peak appears already to be behind, but the economy is operating at a high level in both the current and the following year.

The Government's fiscal policy stimulated the national economy appropriately in 2020, the year of Covid-19. Public expenditure was used to support the economy during the recession and to smooth cyclical fluctuations. In 2021, the second year of Covid-19, the economy seems to be growing strongly throughout the year, and the frame for fiscal policy is left flexible. Therefore, there is a risk that the fiscal impulse of the full year 2021 may prove to intensify the business cycle. However, as it is important to ensure the recovery of the economy after the crisis, pro-cyclical stimulus measures are justified in 2021. According to this ex-ante assessment, the fiscal impulse in 2022 will be contractionary and counter-cyclical.

The forecast of the Ministry of Finance is largely in line with those of other forecasters, particularly in the case of 2022. The forecast on which the state budget is based is therefore realistic as a whole.

The employment measures taken during the parliamentary term have only a modest strengthening impact on public finances compared with the magnitude of EUR 1–2 billion entered in the Government's sustainability roadmap. In terms of fiscal policy, the most significant structural employment measure taken by the Government so far is the decision to remove the right of additional days of unemployment security. The budget proposal for 2022 includes few employment measures with short-term impacts. It is important to ensure the achievement of the objective of bending the growth curve of the debt-to-GDP ratio, which is included in the Government's sustainability roadmap. The improved economic outlook has brought the objective closer. However, in the future, it will be necessary to prepare for the possibility that the need to strengthen public finances may also increase.

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. At present, their fiscal policy steering impact is weak. The General Government Fiscal Plan was completed only on 12 May 2021, which is not in compliance with the deadline laid down in the decree. Furthermore, in anticipation of the establishment of wellbeing services counties, the monitoring of the limit on local government expenditure was abandoned in the Plan, although no decisions have yet been made of the future of the expenditure limit. Therefore, fiscal legislation has not been fully complied with.

Both national and EU legislation emphasize the strengthening of public finances when exceptional circumstances cease to exist. In the fiscal planning for 2023, it would therefore be justified for the Government to place great emphasis on the rule-based need for strengthening, so that any new tax and expenditure decisions for 2023 are in line with the need for strengthening in net terms. The current decisions and outlook are likely to strengthen public finances as referred to in fiscal regulation.

Central government spending limits expenditure has increased considerably during the parliamentary term. This has been enabled by the decision to dispense with the spending limits in 2020 and the exceptions and increases made to the spending limits as from 2021. Many of the changes have been related to the Covid-19 pandemic. The increase in spending limits expenditure is partly due to the flexibility that was already included in the Government Programme and the original spending limits decision. An example of the flexibility is the application of the new mechanism for exceptional circumstances. On the other hand, the decisions taken in spring 2021 to raise the spending limits in 2022 and 2023 clearly violated the principles of the spending limits system. It is important that the spending limits system will continue to serve as a credible tool for long-term planning of central government expenditure.

The general escape clause activated in the EU fiscal framework in spring 2020 remains in force until the end of 2022. It allows Member States to deviate from the objectives set for their general government finances. The EU is considering amending the fiscal rules before the escape clause is deactivated.

A number of options for amending the rules have been proposed in the public debate. All these proposals aim to overcome the problems or shortcomings identified with the current rules, such as poor compliance with the rules as well as their partial pro-cyclicality and complexity. An analysis of the proposals presented so far shows that amendments of the rules may change the conclusions on, for example, whether the projected development of Finland's debt ratio in this decade meets the requirements set by the rules.

In addition, some of the proposals seek to take into account the need for investments related to combating climate change, for example, or the need for adequate public investments in general. The problems with the current rules are reflected particularly in the uncertainty related to the calculation of general government structural balance. Structural balance describes the general government fiscal position without the impact of the business cycle and one-off measures. When structural balance data calculated using two different cyclical adjustment methods are compared, very different conclusions are sometimes arrived at regarding the development of public finances and even compliance with fiscal rules. The cyclical adjustment based on the business cycle indicator of the NAOF's fiscal policy monitoring reacts faster to changes in business cycles than the common cyclical adjustment method of Member States and the Commission. This underlines the need to assess the business cycle comprehensively, using mutually complementary methods.

1 Fiscal policy is navigating out of the Covid-19 crisis

Public finances are recovering slightly faster than anticipated from the slump caused by the Covid-19 crisis. The ratio of government debt to GDP has risen considerably in Finland during the pandemic but moderately compared with the other EU countries. The large debt taken by Finland in 2020 and 2021 has 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.

Finland's economic outlook collapsed in spring 2020 as a result of the Covid-19. Based on current data, the economic outlook appears to have turned positive in the second quarter of 2021. According to the business cycle indicator of the NAOF's fiscal policy monitoring, the economy has recovered almost as rapidly this year as it collapsed in the previous year. On the basis of the forecast of the business cycle indicator, the highest cyclical peak appears already to be behind, but the economy is operating at a high level in both the current and the following year.

The Government's fiscal policy stimulated the national economy appropriately in 2020, the year of Covid-19. Public expenditure was used to support the economy during the recession and to smooth cyclical fluctuations in 2020. In 2021, the second year of Covid-19, the economy seems to be growing strongly throughout the year, and the frame for fiscal policy is left flexible. Therefore, there is a risk that the fiscal impulse of the full year 2021 may prove to intensify the business cycle. However, as it is important to ensure that the economy recovers after the crisis, pro-cyclical stimulus measures are justified in 2021. According to this ex-ante assessment, the fiscal impulse of 2022 will be contractionary and counter-cyclical.

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1.1 The outlook for public finances over the next few years has become brighter after the slump caused by Covid-19

The Covid-19 pandemic has had a significant impact on general government debt and deficit relative to GDP. The deficit is forecast to decrease rapidly after the plunge in 2020 (Figure 1). The situation at the end of the review period 2019–2025 is still forecast to remain weaker, but only slightly, than in 2019. In the Ministry of Finance's forecast, the government debt-to-GDP ratio is expected to even out after the sharp increase in 2020 but to continue to show a modest upward trend. In the EU Commission's forecast, it is expected, in practice, to stabilize.

Although the Covid-19 crisis has had an extremely strong impact on general government finances and the national economy, the situational picture and outlook have improved somewhat in the forecasts of both the European Commission and the Ministry of Finance since autumn 2020. In autumn 2020, the government deficit was expected to continue to exceed the 3% reference value in 2022, but in autumn 2021, the deficit is expected to be significantly lower. Thus, the economy is recovering from the crisis faster than previously expected.

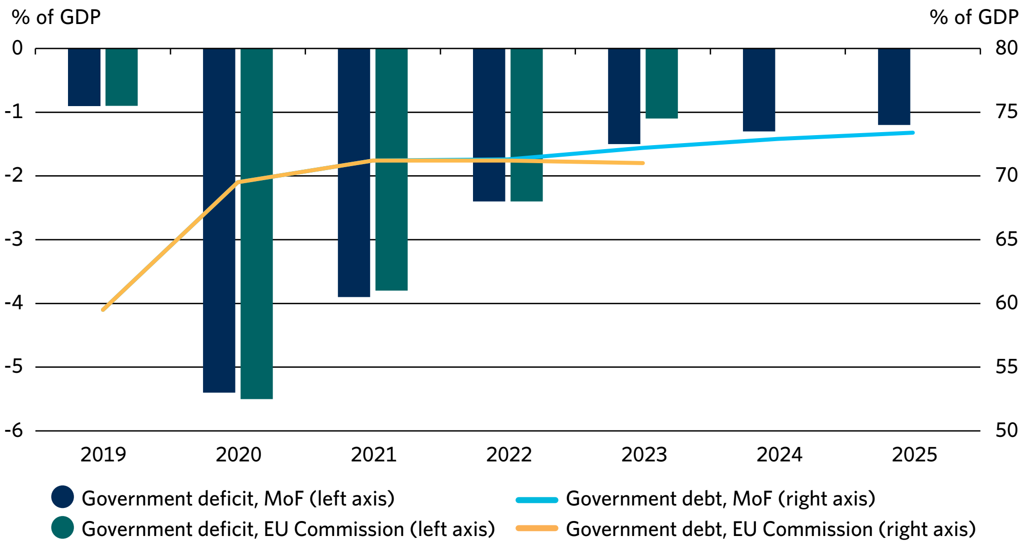

Figure 1: Government deficit and debt forecasts for 2021–2025, autumn 2021. Sources: Ministry of Finance (MoF) and EU Commission.

Finland's public debt has increased considerably during the pandemic but moderately compared with the other EU countries

Overall, Finland's general government finances have survived the Covid-19 pandemic better than average compared 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 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 the figure, 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 EU Commission's autumn 2019 forecast of the development of debt ratios. At the time of preparing the forecast, the outbreak of the Covid-19 pandemic was not yet known and therefore not yet included in the debt forecast. Since the forecasting of debt ratios naturally involves a number of uncertainties, the actual debt ratios would have deviated from the Commission's forecast even without the pandemic. In any case, the figure must be considered indicative instead of an accurate estimate.

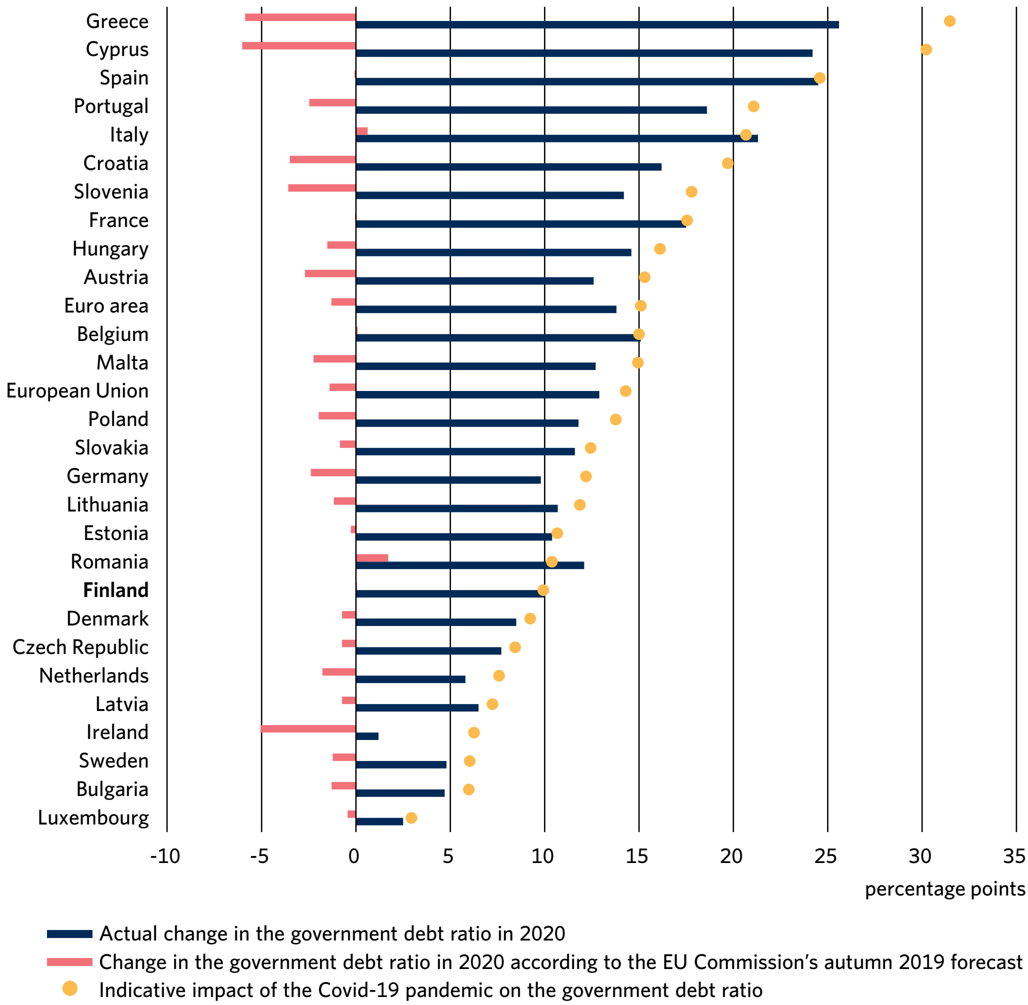

Figure 2: Actual change in the government debt-to-GDP ratio in 2020 based on statistics, the EU Commission's autumn 2019 forecast of the development of debt, and the estimated impact of the Covid-19 pandemic on the debt ratio. Sources: EU Commission, Eurostat, NAOF.

When the development in 2020–2021 is examined on the basis of the Commission's spring 2021 forecast (Figure 3), the conclusion reached on the development of Finland's general government debt ratio in 2020 is similar to those based on the above figures. The development of the government debt-to-GDP ratio has been 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. However, the general fiscal policy approach chosen for the management of the crisis has contributed to the mitigation of economic damage.

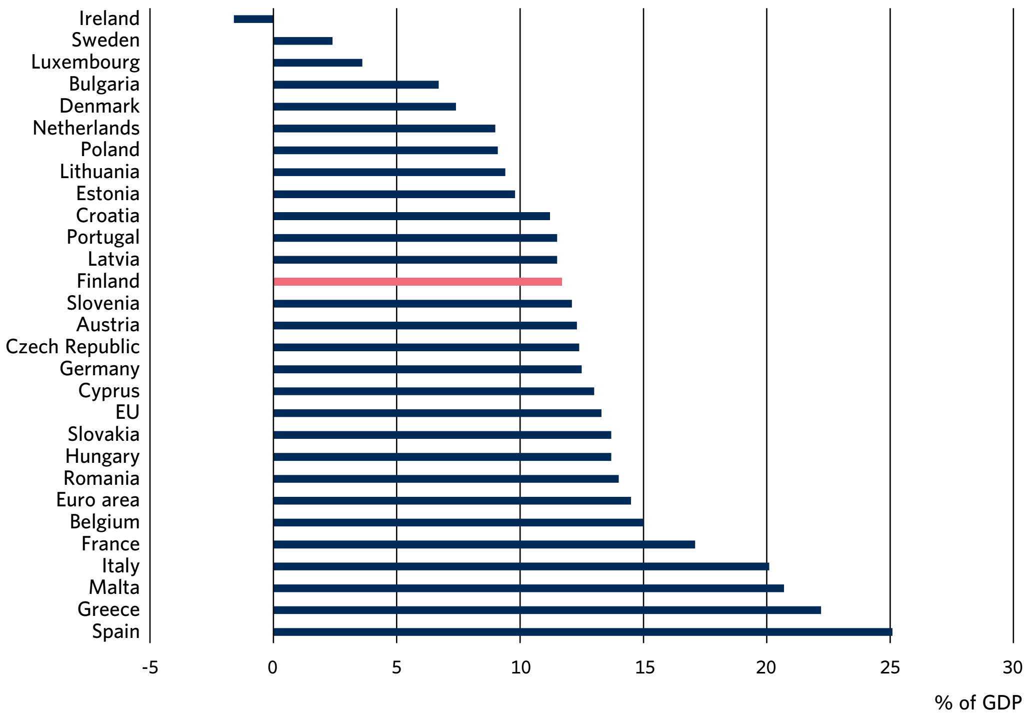

Figure 3: Growth of the government debt-to-GDP ratio in the EU countries in 2020–2021 Source: EU Commission's forecast of 11 November 2021.

Government borrowing continues to be implemented at zero interest rate in practice

The growth of government debt has not been reflected in interest expenses, but interest payments have decreased. This is because recently, the debt that is maturing has been more expensive on average than the new debt taken later. 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).

In 2021, the interest situation has remained unchanged, and the average interest rate of new debt has continued to be negative. This is particularly due to the extremely low interest rates on short-term debt. However, the interest rates on long-term debt also continue to be low. The situation will affect the interest expenses of government debt in the next few years and provide fiscal policy with a margin of manoeuvre. 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.

In 2021, the market interest rate on 10-year central government bonds has slightly increased. At the beginning of the year, the interest rate was about 0.5% negative, and in mid-October it was almost exactly zero.

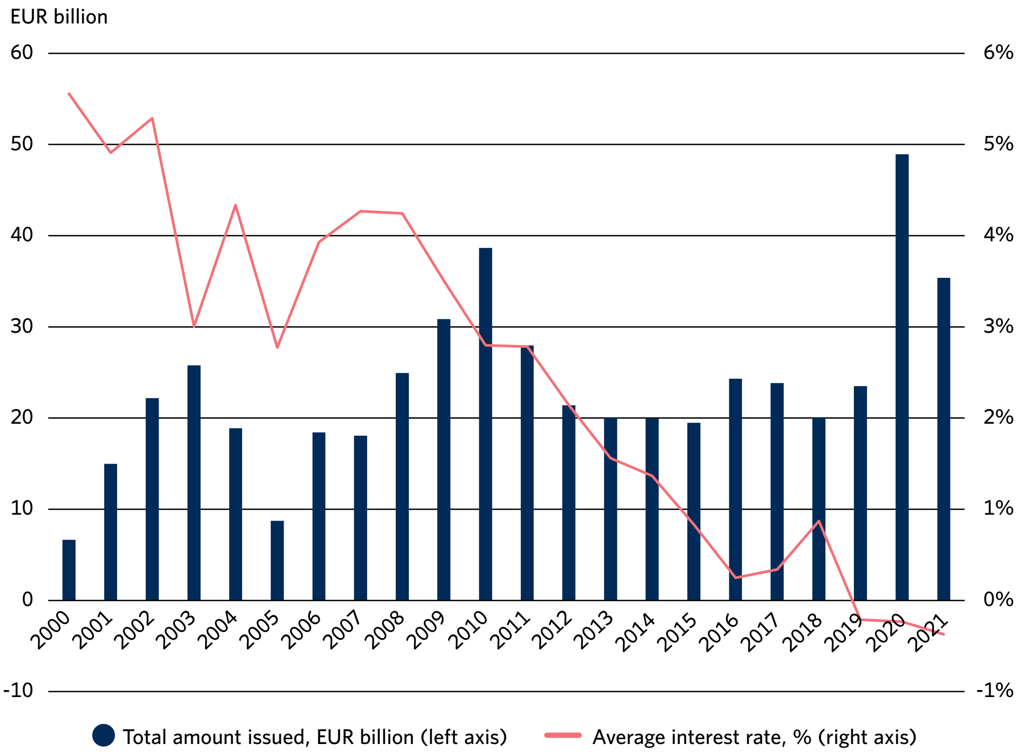

Figure 4: Central government bonds issued in 2000–2021 and actual average interest rates (yield) on the issues. The average interest rate has been calculated as a weighted average based on the issues whose interest rates have been published on the website of the State Treasury. The issuing methods and 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 25 October. Source: State Treasury and NAOF.

The Covid-19 crisis has highlighted the risks of state guarantees

State guarantees and other contingent liabilities are not directly reflected in government debt and deficit, but it is important to examine them because the risk they pose to public finances may be realized. The amount of state guarantees has been growing in Finland for a long time (Figure 6). During the review period, export credit guarantees, in particular, have increased. 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.[1]

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). 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 payment of EUR 349 million from the State Guarantee Fund. The decrease in the loss reserves described above relates to the loss reserves for export credit guarantee and special guarantee operations, not to the final or paid loss compensations. In the first half of 2021, the reserves increased slightly due to the profit reported by the export credit guarantee and special guarantee operations.

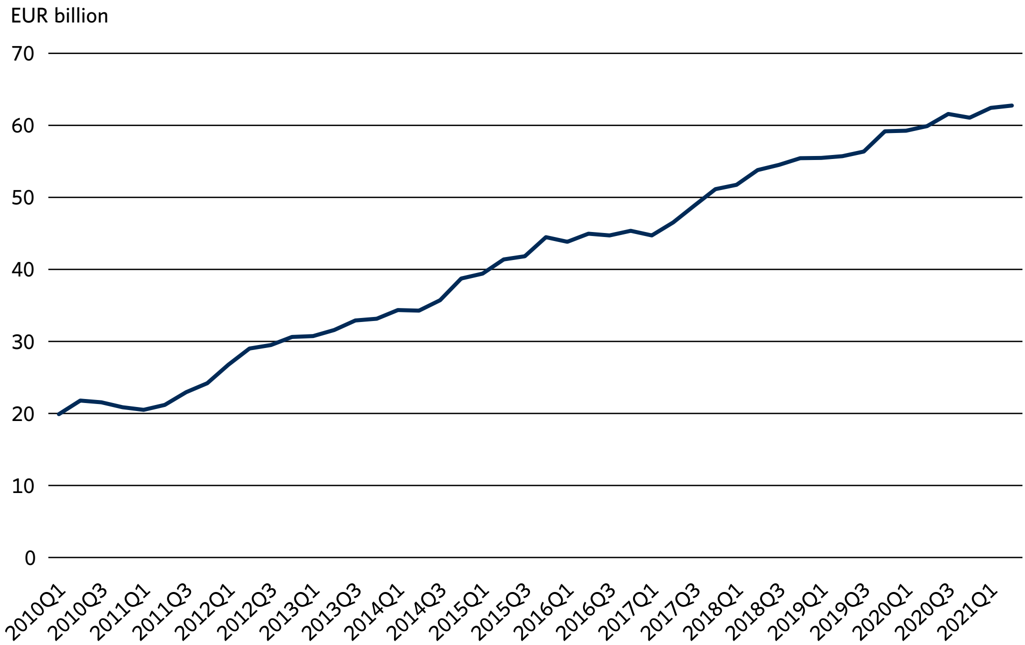

Figure 5: Development of state guarantees 2010–2021. Source: Statistics Finland.

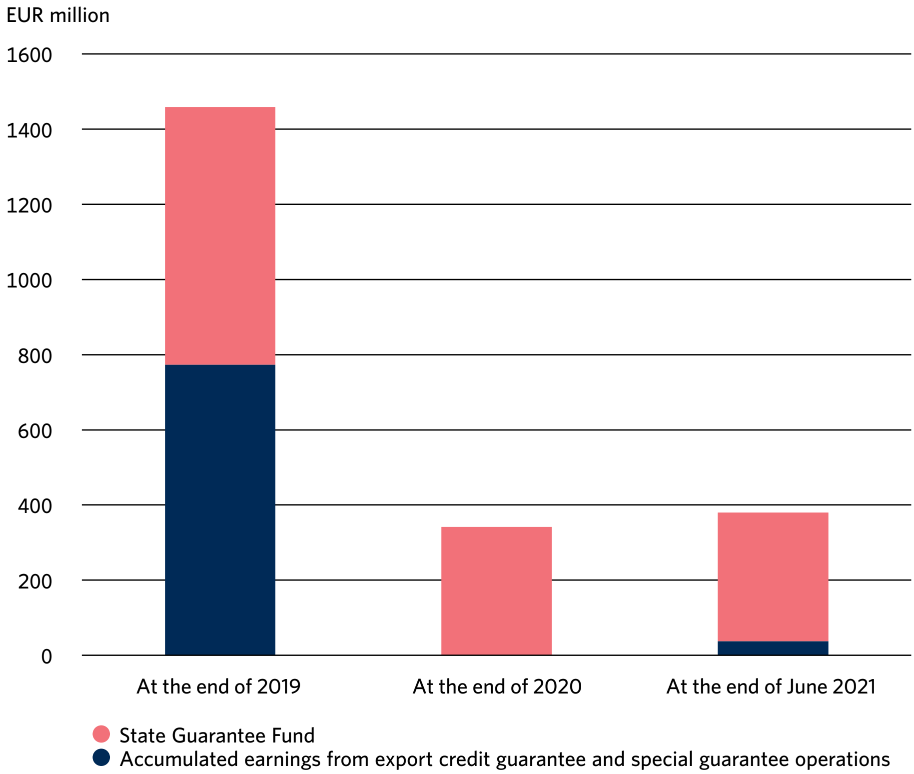

Figure 6: Development of the reserves related to Finnvera's export credit guarantee and special guarantee operations in 2020–2021. Source: Finnvera

The business cycle indicator indicates strong economic development since spring 2021

The colour code of the business cycle heatmap produced by the NAOF's fiscal policy monitoring is red, indicating strong economic development since spring 2021 (see Figure 7). The value of the composite indicator for June 2021 is even historically high. The heatmap shows that the strong economic development has stabilized.

The colour code turned red for the first time after the outbreak of the Covid-19 pandemic in April 2021. 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 heatmap shows that this year's economic recovery has been almost as strong as the collapse of the previous year.

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Business cycle heatmap produced by the NAOF's fiscal policy monitoring

The business cycle heatmap is a tool that describes the economic cycle in Finland by means of colour codes and is based on 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.

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, the economy is growing faster than average, e.g. the employment rate is improving, and salaries are rising. Accordingly, blue represents a slowdown in economic growth. The higher the share of red or blue indicators at the same time, the more likely it is that the economy is experiencing either good times or bad times.

A composite indicator whose value is calculated from the heatmap variables has also been compiled of the individual business cycle indicators. The timing of the composite indicator and the fact that it is revised over time only to a minor degree make it a good additional tool for measuring the business cycle, alongside the output gap (see Strifler, M. and Kokkinen, A., 2021a[2]).

Year	Vacancies, change	Capacity utilization	Consumer price index, change	Consumer confidence	Wages and salaries, change	Services confidence	Construction confidence	Industrial confidence	Employment rate, change	Unemployment rate, change	Retail trade confidence	Composite indicator (weighted)
⊟ 2021												
9		0.97		2.05		0.42	0.75	1.75			0.33	0.61
8	2.95	1.21	0.60	1.58		0.25	0.63	1.83	2.16	1.01	0.47	1.27
7	2.92	0.85	0.36	1.38	1.24	0.77	0.43	1.41	1.40	1.13	0.03	1.23
6	3.09	0.95	0.44	1.54	2.38	0.54	0.02	1.64	1.87	1.55	0.71	1.49
5	2.49	0.63	0.60	1.18	2.25	0.34	-0.15	1.21	2.63	1.86	0.69	1.39
4	2.06	0.48	0.52	1.63	0.98	-0.15	0.02	0.84	0.18	1.60	0.82	0.85
3	0.87	0.29	-0.11	0.06	-0.56	-1.40	-0.49	0.15	0.18	-0.11	-0.01	-0.09
2	-0.65	-0.03	-0.42	0.32	-0.43	-1.46	-0.94	-0.26	-0.17	-1.35	0.30	-0.51
1	-0.79	0.31	-0.42	0.26	-1.63	-1.28	-0.75	-0.12	-1.71	-1.53	0.04	-0.74
⊟ 2020												
12	-1.10	-0.26	-0.97	-0.51	-0.40	-1.70	-0.72	-0.40	-1.69	-1.87	0.02	-0.95
11	-1.13	-0.39	-0.97	-0.30	-1.40	-1.74	-0.64	-0.97	0.24	-1.71	-0.31	-0.99
10	-1.48	-0.65	-0.97	-0.80	-0.43	-1.74	-0.46	-1.09	-0.45	-1.80	-0.64	-1.05
9	-1.42	-0.57	-0.97	-0.68	-0.76	-1.83	-0.46	-1.46	-0.38	-1.80	-0.54	-1.12
8	1.52	-0.80	-0.97	0.60	-1.87	-1.71	-0.45	-1.37	-1.55	-2.00	0.15	-1.35
7	-1.20	-0.49	-0.66	-0.08	-0.56	-2.01	-0.22	-1.09	-1.18	-2.12	-0.57	-1.06
6	-1.55	-0.56	-1.13	-0.46	-1.94	-3.30	-0.87	-1.62	-1.31	-3.19	-0.88	-1.70
5	1.43	-0.62	-1.29	-1.60	-3.44	-3.59	-0.71	-1.62	-2.04	-4.62	-0.70	-2.19
4	1.45	-0.46	-1.37	-2.30	-1.33	-3.44	-0.78	-1.54	-0.74	-4.49	-2.11	-1.89
3	-1.47	-0.14	-0.66	-0.98	-0.26	-1.06	0.43	-0.49	-0.67	-1.40	-1.22	-0.76
2	-0.51	0.02	-0.50	-0.46	-0.30	-0.38	0.58	-0.33	-0.03	0.10	-0.69	-0.26
1	0.11	-0.03	-0.35	-0.51	0,51	0.01	0.52	-0.60	0.68	0.24	-0.35	-0.02

Figure 7: Heatmap produced by the NAOF's fiscal policy monitoring (20 October 2021). Source: Statistics Finland, Ministry of Economic Affairs and Employment, European Commission, Confederation of Finnish Industries, and calculations by the NAOF's fiscal policy monitoring. Data retrieved through Macrobond.[3]

Figure 8 shows the values of the monthly and annual composite indicator. The monthly composite indicator illustrates the cyclical conditions much more sensitively than the annual indicator. This is particularly evident in the observations for 2020 and the speed and accuracy with which the indicator reacted to the Covid-19 crisis. The monthly composite indicator was very sensitive to the sudden drop in economic activity in Finland in April 2020 and to the rapid turnaround of the business cycle in spring 2021.

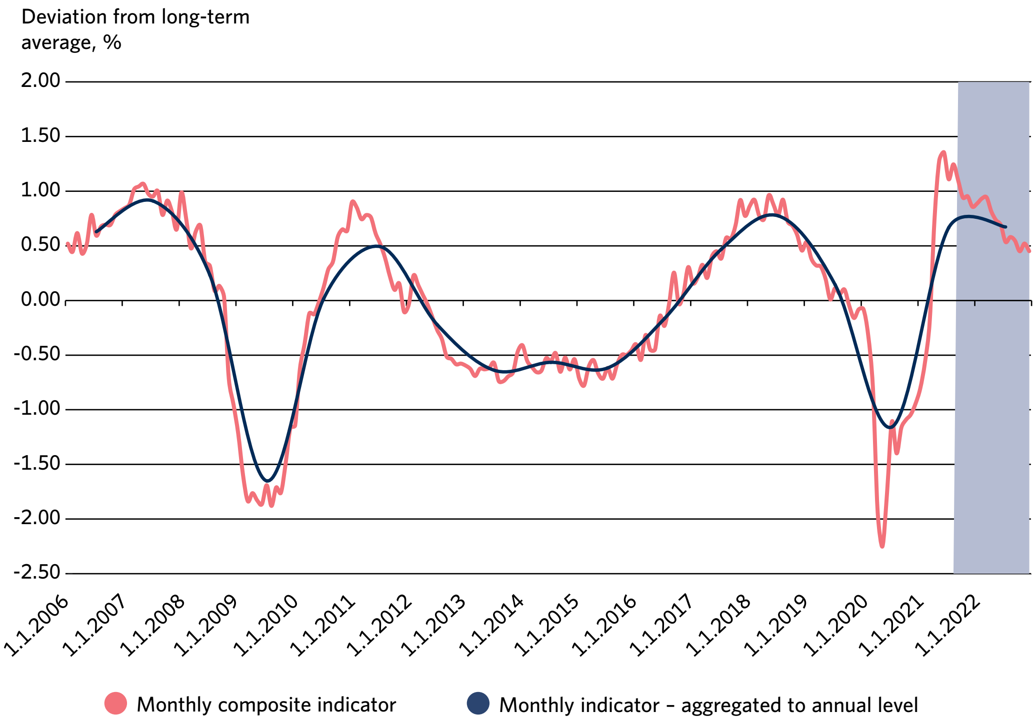

Figure 8: Composite indicator on the monthly and annual level and forecast for the current year (on grey background). Source: Statistics Finland, Ministry of Economic Affairs and Employment, Confederation of Finnish Industries, European Commission. Calculations and forecasts: NAOF's fiscal policy monitoring.[4]

Although the business cycle heatmap illustrates the development of the business cycle on a monthly level, it is unable, in the middle of the year, to illustrate the business cycle for the full year. Nevertheless, it is necessary to assess the average business cycle for the full year, as the counter-cyclicality or pro-cyclicality of fiscal policy is primarily assessed on annual level. In addition, in the planning of fiscal policy, it is important to have an idea of the following year's business cycle. Therefore, the NAOF's fiscal policy monitoring has developed a forecast based on the business cycle heatmap (Strifler, M. and Kokkinen, A., 2021b[5]).

Forecast based on the business cycle heatmap produced by the NAOF's fiscal policy monitoring

The forecast of the heatmap produced by the NAOF's fiscal policy monitoring is 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's fiscal policy monitoring aims to ensure that its forecast utilizes these forecasters' expertise as widely as possible. This makes the forecast as neutral as possible.

The forecast process is, in brief, as follows[6]:

A monthly forecast is produced for each single indicator or the heatmap for the remaining months of the current year and the months of the following year. Based on them, a forecast is calculated for the heatmap's composite indicator.

In practice, the forecasts of other actors are utilized in the heatmap forecast in such a manner that their annual forecasts are adjusted to the remaining months of the current year and the months of the following year. How the indicator develops during the year depends thus on the modelling choices made by the NAOF's fiscal policy monitoring, but, on the annual level, the forecast corresponds exactly to that of the external forecaster.

In addition, the development projected by the euro area indicators is applied to Finland's corresponding indicators. In this methodological framework, too, the forecasts of individual indicators depend on the modelling choices made by the NAOF's fiscal policy monitoring. However, the most important part in the preparation of the forecasts for the Finnish indicators is played by the external euro area forecast.

These methods were applied to prepare the forecasts for nine heatmap variables with a combined weight of 0.88. The NAOF's fiscal policy monitoring prepared forecasts independently of the forecasts of other actors for only two variables; these were calculated by statistical time series analysis (combined weight 0.12).

The forecast is based on the heatmap data and other specified statistics available by 19 October 2021.

Figure 8 also presents a forecast for the remaining months of the current year and for 2022. According to the forecast, the economy is operating at a higher level than average in both the current and the following year. Based on the monthly forecast, the highest cyclical peak seems already to be behind. The indicator will slowly fall towards neutral cyclical conditions but will nevertheless remain clearly above zero. It should be noted that the heatmap forecast involves a high level of uncertainty, which is typical of all economic forecasts.

Figure 9 shows that the forecast of the composite heatmap indicator for the current and the following year differs considerably from the output gap estimate. According to the composite indicator forecast, the economy will already be clearly above the long-term average in the current and the following year, whereas according to the output gap estimate, it will still be below the estimated potential output in the current year and come close to the potential output in the following year.

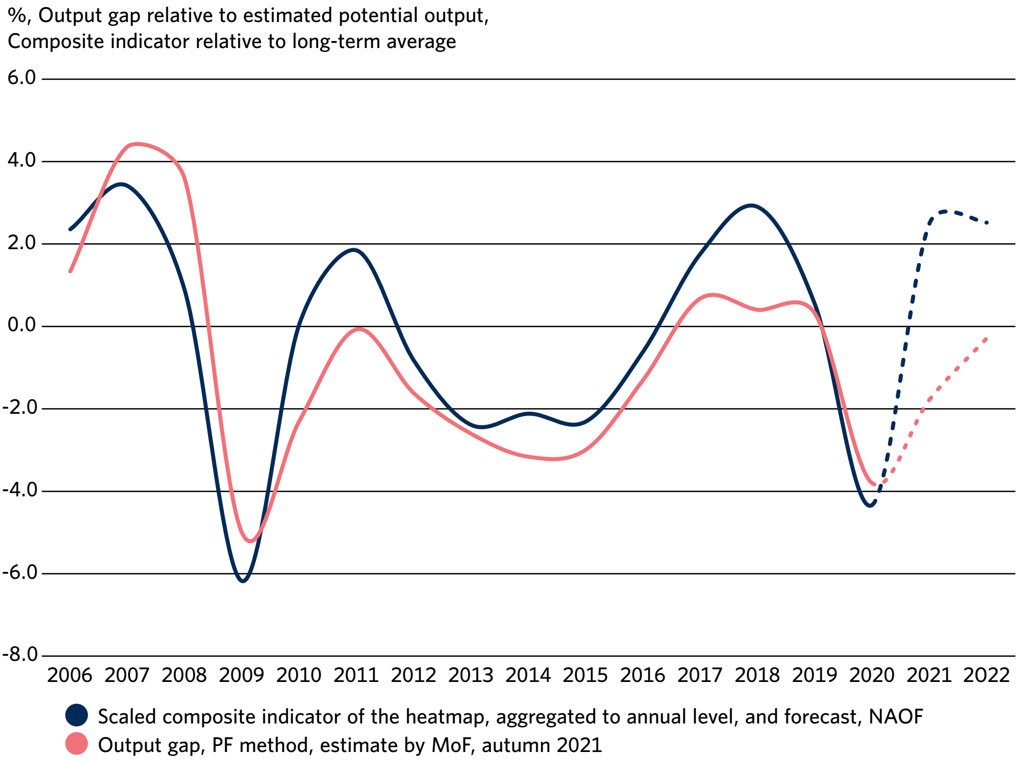

Figure 9: Composite indicator of the heatmap and its forecast, and the output gap estimate of the Ministry of Finance. Forecast for 2021 and 2022 (dashed line). The variation (standard deviation) of the business cycle indicator of the heatmap has been scaled to be comparable with the variation (standard deviation) of the output gap. Source: Output gap: MoF; Composite indicator of the heatmap: Statistics Finland, Ministry of Economic Affairs and Employment, European Commission, Confederation of Finnish Industries, calculations by NAOF's fiscal policy monitoring.[7]

Both assessments of the upcoming business cycle should be treated with caution. The difference in the understanding of the upcoming business cycle is reflected in the assessment of the fiscal stance (section 1.2) and compliance with the objectives set by the fiscal framework (section 2.1).

1.2 Fiscal policy provided counter-cyclical stimulus in 2020 but appears to be pro-cyclical in 2021

The Government's fiscal policy stimulated the national economy counter-cyclically in 2020, the year of Covid-19. Public expenditure was used to support the economy during the recession and to smooth cyclical fluctuations in 2020. According to the heatmap produced by the NAOF's fiscal policy monitoring, the business cycle turned positive already in the second quarter of 2021. The positive development has continued to be strong throughout the year.

> The appropriateness of the fiscal stance of 2021 to the business cycle can best be assessed ex post.

It is possible that the Government's discretionary stimulus measures have accelerated economic development pro-cyclically in 2021 when the economy is taking an upturn. A pro-cyclical fiscal policy may intensify cyclical fluctuations and pose the risk that the economy may overheat.

On the other hand, the fourth wave of the pandemic occurred in 2021 following a new, more contagious virus variant. As a result of this and the deep recession following the lockdown measures taken in 2020 to prevent the spreading of a serious infectious disease, it can be considered sensible to ensure that the expansionary fiscal policy is not brought to an end too soon. In addition, efforts have been made to coordinate fiscal policies at EU level to promote the recovery of the European economy as a whole. In this sense, pro-cyclical stimulus measures can still be considered justified in 2021.

The appropriateness of the fiscal stance of 2021 to the business cycle remains to be definitively assessed ex post. This will depend significantly on whether the recent rise in inflation will remain short-lived or become a longer-term problem. The composite indicator of the NAOF's heatmap signals the risk of pro-cyclical stimulus and cyclical intensification, bottlenecks in production, overdemand for labour, and inflation. In addition, during an economic upturn, a pro-cyclically stimulating fiscal policy does not contribute to the building of fiscal buffers for a downturn.

Fiscal stance and fiscal impulse

In this report, the NAOF's fiscal policy monitoring has adopted a new approach to examining the orientation of fiscal policy: it is assessed by means of both fiscal stance and fiscal impulse.

The fiscal stance is measured by means of cyclically adjusted structural primary balance in relation to the business cycle. The fiscal impulse, in turn, is measured by means of the change in the structural primary balance in relation to the change in the business cycle. This approach corresponds to the method that the European Fiscal Board and the International Monetary Fund use to assess the orientation of fiscal policy[8].

It should be noted that the terms 'fiscal stance' and 'fiscal impulse' describe the situation in 2020 and 2021 comprehensively. After 2019, the structural primary balance turned considerably more negative due to the strong fiscal stimulus. Even if the fiscal impulse were neutral or negative in 2022, the fiscal stance would remain expansionary.

The method and terminology used in the assessment of the orientation of fiscal policy may vary depending on the examiner. For example, when examining the fiscal stance, the European System of Central Banks uses the change in the structural primary balance in relation to the change in the business cycle (i.e., in the case of the ECB, the output gap) (see e.g. ECB 2017[9]).

Figure 10 illustrates the cyclically adjusted structural primary balance in relation to the business cycle. Nominal primary balance refers to the balance relative to GDP net of interest payments. When the impact of the business cycle and one-off factors are eliminated from the nominal primary balance relative to GDP, the cyclically adjusted structural primary balance is obtained. It aims to describe whether the Government's discretionary fiscal policy has functioned counter-cyclically, smoothing cyclical fluctuations.

The official cyclical adjustment of the primary balance is performed using the production function method jointly agreed by the EU Member States and the output gap based on it. However, output gap figures are usually revised to a significant degree. Especially in the case of small open economies, such as Finland, output gap estimates are revised considerably. For this reason, the fiscal stance will be assessed in the following based on both the output gap and the composite indicator of the business cycle heatmap produced by the NAOF's fiscal policy monitoring.

The vertical axis of Figure 10 illustrates the discretionary fiscal stance in 2017–2021 based on the structural primary balance. The primary balance has been cyclically adjusted by means of both the output gap (red dots) and the composite indicator of the heatmap (black dots). According to the data available in autumn 2021, the structural primary balance has been negative throughout the review period based on both cyclical adjustments.

As can be seen from the figure, both cyclical adjustments produce similar results for the structural primary balance on the vertical axis for the years examined ex post. On the other hand, for the current year 2021, the structural primary balance based on the composite heatmap indicator appears to be more negative than the one based on the output gap. It should be noted that the estimate for the current year that is based on the output gap will still be revised to a significant extent as a result of cyclical adjustment. The estimate based on the heatmap produced by the NAOF's fiscal policy monitoring, in turn, will not be revised to any significant extent as a result of cyclical adjustment. Revisions to real-time cyclical adjustments are, in fact, a problem with the output gap method.

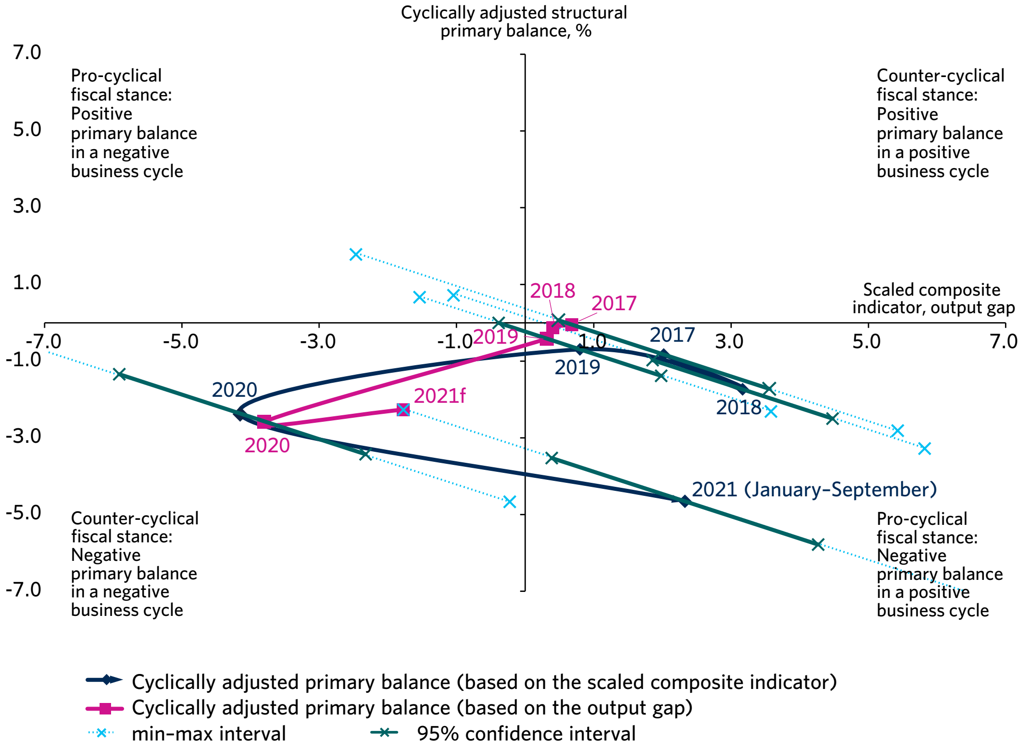

Figure 10: Fiscal stance in relation to the business cycle: the structural primary balance based on the output gap and the cyclical heatmap indicator in relation to the business cycle based on the output gap and the cyclical heatmap indicator in 2017–2021. The variation (standard deviation) of the cyclical heatmap indicator has been scaled to be comparable with the variation (standard deviation) of the output gap. (See Strifler, M. and Kokkinen, A., 2021c[10]) The estimates based on the output gap method of both the business cycle and the cyclically adjusted structural primary balance may be revised later even to a significant extent. Source: Ministry of Finance and NAOF's fiscal policy monitoring.

In the same figure 10, the horizontal axis illustrates the estimate of the business cycle based on both the output gap and the composite indicator of the heatmap. It can be seen from the figure that there are also differences between the estimates of the business cycle for the previous years. Based on the composite indicator (black dots), the years 2017 and 2018, and particularly the current year 2021, were more positive than based on the output gap (red dots).

When the estimates of the structural primary balance shown in the figure are examined in relation to the estimates of the business cycle illustrated on the horizontal axis, it can be seen whether the discretionary fiscal policy has been counter-cyclical or pro-cyclical relative to the business cycle. Here, too, the greatest differences between the estimates based on the output gap and the heatmap can be seen in 2017–2018 and the current year 2021.

The eleven business cycle indicators of the heatmap have been used to calculate a 95% confidence interval for the business cycle estimate, as well as the minimum and maximum values. The structural primary balance of 2017 based on the output gap falls within this confidence interval, which means that, statistically, there are no significant differences between all the business cycle indicators in the structural primary balance estimates

The confidence interval calculated for the business cycle indicator of the heatmap illustrates the uncertainty related to the fiscal stance.

based on the output gap and the heatmap. On the other hand, the structural primary balance value for 2018 based on the output gap differs statistically significantly from the structural primary balance value based on the heatmap in relation to the business cycle. As regards 2018, the fiscal stance should therefore be interpreted as pro-cyclical in a positive business cycle on the basis of the 95% confidence interval of the cyclical heatmap indicator.

Line describing the confidence intervals of the business cycle indicator and the structural primary balance

Figure 10 shows two confidence intervals. However, the confidence intervals are illustrated here by a line, as uncertainty is generated only by the business cycle indicator. The composite indicator of the heatmap is produced from 11 indicators, which are regarded as a sample of all possible business cycle indicators. The aim is to establish a confidence interval for the population of business cycle indicators based on the statistical sampling theory and the distribution of the *t*-test variable.

A minimum–maximum interval has also been calculated based on the heatmap indicators. For this purpose, the business cycle indicator has been formed with the help of only the lowest and highest sub-indicator in the month in question. In this case, the value of the business cycle indicator is obtained by attaching weight 1 (i.e. full weight) to the relevant indicator.[11]

When the structural balance is cyclically adjusted, the confidence interval (in the same way as the balance) is multiplied by semi-elasticity (0.58), whereby the variation of the confidence interval on the vertical axis of the figure, i.e. the axis illustrating the structural primary balance, is smaller than on the horizontal axis.

The result is a linear diagonal which represents a confidence interval for both the business cycle indicator of the horizontal axis and the structural primary balance of the vertical axis. In this case, uncertainty is generated by only one source, i.e. the business cycle indicator, which is found on the horizontal axis and also used on the vertical axis for calculating the structural primary balance. Therefore, the confidence interval is illustrated by a diagonal instead of a range.[12]

In 2020, the fiscal stance provided counter-cyclical stimulus according to both calculation methods. For 2021, in turn, the structural primary balance estimate based on the output gap differs most from the value based on the composite heatmap indicator: it is outside the 95% confidence interval calculated by means of the eleven business cycle indicators of the heatmap and at the edge of the minimum–maximum range produced by the eleven business cycle indicators. The business cycle estimate for 2021 produced by means of the output gap and the structural primary balance based on it should be treated with caution. Based on the output gap, the fiscal stance in 2021 would have continued to provide counter-cyclical stimulus. Based on the current data provided by the eleven business cycle indicators of the heatmap and the 95% confidence interval for the sampling distribution of statistical *t*-tests, the fiscal stance for the current year has been pro-cyclically stimulating.

Another question is whether it is sensible, after a severe shock as the one caused by Covid-19, to continue with a pro-cyclical fiscal policy in the following year. It is also possible to justify continuing an expansionary fiscal policy with the limited possibilities of monetary stimulus when interest rates are close to zero. In any case, the composite indicator of the heatmap signals the risks of pro-cyclical stimulus, cyclical intensification, bottlenecks in production, overdemand for labour, and inflation.

The structural primary balance estimate for 2021 based on the heatmap forecast does not differ much from the above value based on the observations of January–September (see Figure 11). However, the structural balance based on the forecast of the composite indicator continues to differ clearly from the structural balance based on the output gap. Figure 11 shows that there are also differences in the assessment of the fiscal stance for 2022. Based on the composite indicator forecast, the fiscal stance will still be pro-cyclical in a positive business cycle, whereas based on the output gap, it will be counter-cyclical in a negative business cycle.

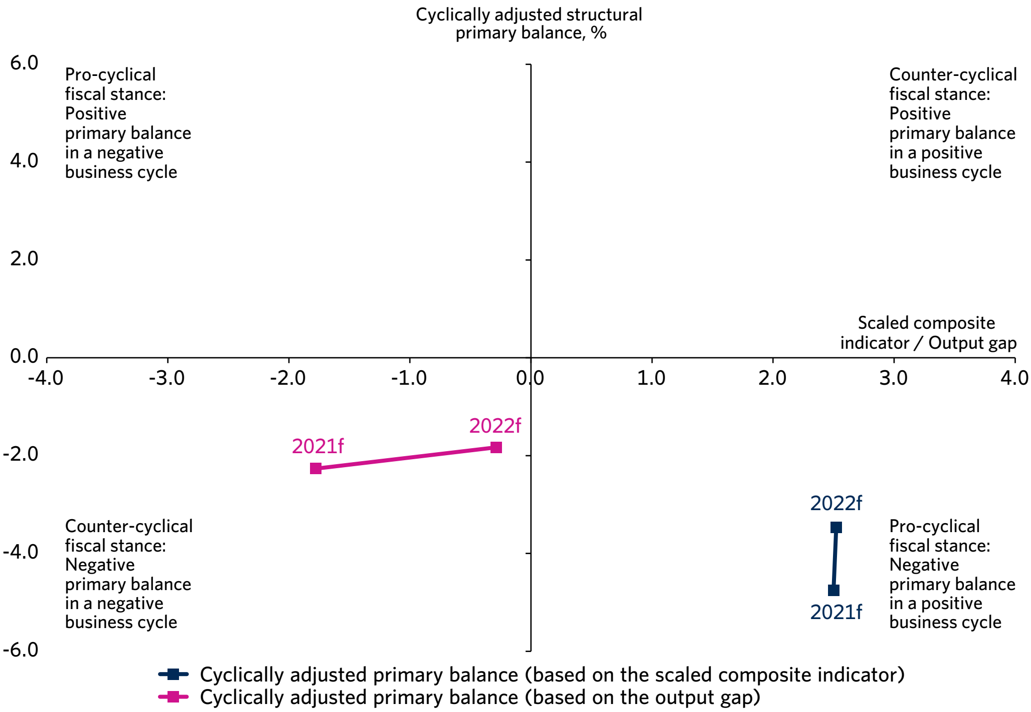

Figure 11: Projected fiscal stance in relation to the business cycle in 2021 and 2022. The output gap values and the structural balance estimates calculated by means of it are based on the Ministry of Finance's primary balance forecast and the results of the jointly agreed CAM method. The composite indicator values and the structural balance estimates calculated by means of it are based on the heatmap forecast and the primary balance forecast of the Ministry of Finance.[13] Source: Ministry of Finance and NAOF's fiscal policy monitoring.

Figure 12, in turn, illustrates the fiscal impulse by examining the change in the structural primary balance in relation to the change in the business cycle indicator. The fiscal impulse estimate (Figure 12) based on the composite indicator of the heatmap produced by the NAOF's fiscal policy monitoring confirms the estimate of the impulse based on the output gap for 2020.

However, for 2021, the conclusions differ from each other even in this respect. Based on the output gap, the impulse is counter-cyclically contractionary, whereas based on the heatmap forecast for the full year 2021, the fiscal impulse is pro-cyclically expansionary. This means that the structural primary balance is deteriorating at the same time that the cyclical conditions are improving. This would not be desirable, as a pro-cyclical fiscal impulse would exacerbate cyclical fluctuations.

For 2022, the fiscal impulse estimates based on the output gap and the composite indicator forecast are closer to each other, and both estimates indicate that the impulse is counter-cyclically contractionary. According to the business cycle indicator of the heatmap, the fiscal stance will remain pro-cyclical in 2022, but according to both indicators, the fiscal impulse will change the fiscal policy in the right direction in relation to the business cycle.

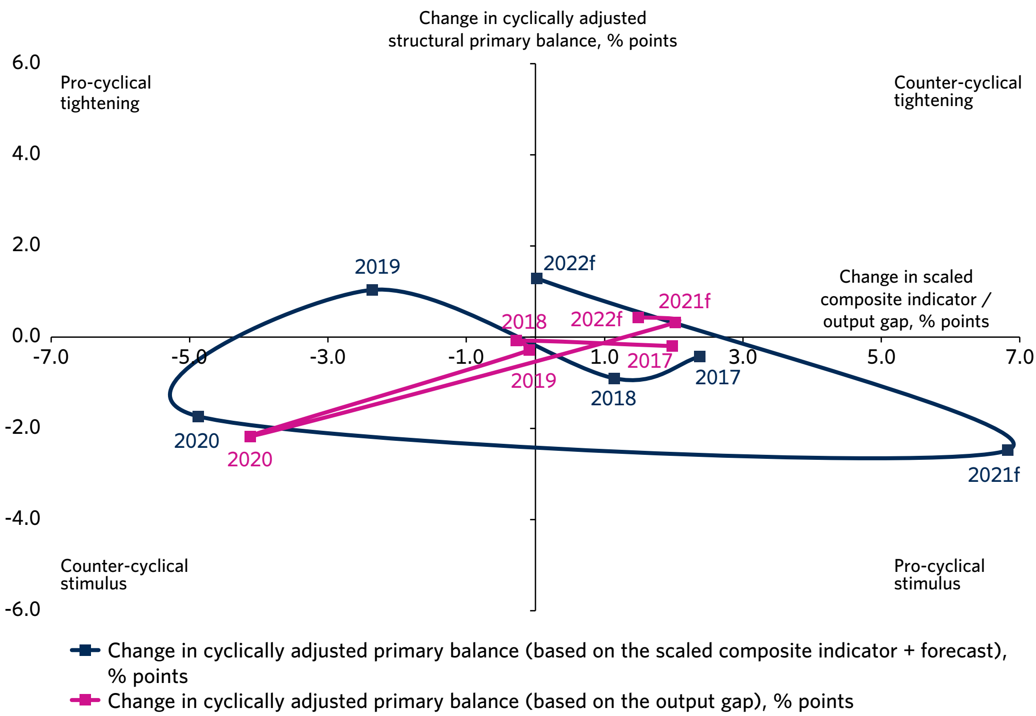

Figure 12: Fiscal impulse in relation to the change in business cycle: the change in structural primary balance (cyclical adjustment based on the output gap and the composite indicator) in relation to the change in both the output gap and the composite indicator produced by the NAOF's fiscal policy monitoring. The estimates for 2021 and 2022 are based on forecasts. Source: Ministry of Finance and NAOF's fiscal policy monitoring.

1.3 The budget proposal for 2022 includes few employment measures with short-term impacts

The Government's objective is to improve the employment rate to 75 per cent by the middle of the decade and, through employment measures, to increase 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 sustainability roadmap updated last spring, the impact of employment measures on public finances is EUR 1–2 billion. In connection with the budget proposal for 2022, the Government decided only on a few new measures to permanently improve employment. The Government announced three employment measures: raising the tax credit for work income for people over 60 years of age, raising the income limits for student aid, and a fast lane to employment-based immigration. The estimated impact of the measures on employment and public finances is limited in view of the objective. It should also be noted that raising the income limits for student aid is a temporary measure and does not contribute to the Government's objective of stabilizing the general government debt ratio by the end of the decade. The impact of the fast lane to employment-based immigration has not been assessed. The gradual increase in the tax credit for work income for people over 60 years is therefore the only employment measure decided in the budget session that has been assessed and has a permanent impact on public finances. According to the assessment by the Ministry of Finance, the fiscal impact of this measure is negative.

Table 1: Impact of the Government's employment measures on public finances.

Measures	(A) Impact assessment of the number of new employed, persons (MoF, other ministries, other actors)	(B) Estimated potential number of new employed, persons (ministry responsible for preparing the measure)	Net impact on public finances, € million (based on the impact assessment of the number of new employed (column A), MoF)	Net impact on public finances, € million (based on the MoF's impact assessment of the number of new employed, NAOF)
Decisions taken in the budget session 2021	150–650	-	-15– - 66	-15– -66 [1]
Decisions taken in the budget session 2021	11 000	40 000–44 500	150	119–165
Decisions taken in 2020 (budget session and others) [2]	30,500–32,500	30,500–32,500	325	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	42,000–45,000	71,000–77,500	+409– +460	**+242– +668**
Total: Including negative decisions, direct	24,500–36,500	–	–	**−222– +502**
Total: Sustainability gap pressure projection as benchmark	27,300–32,200	–	–	**−68– +388**

[1] Based on the impact assessment of the Ministry of Finance. At the time of writing this report, no accurate information on the details of the reform is yet available.

[2] Does not include a preliminary estimate of the consequences of raising the tax credit for work income for those over 60 years of age in the employment package for those over 55 years of age. The estimate was specified and taken into account in the decision of the budget session 2021.

Raising the tax credit for work income is the only permanent employment measure taken in the budget session 2021. Therefore, it is the only measure taken into account in Table 1 in connection with the budget session of 2021. A decision on raising the credit for work income was already made in connection with the employment package for those over 55 years. Due to the small number of new measures, the overall picture of the Government's employment measures does not change much from spring 2021. However, in order to get an overall picture of the impact of the employment measures on public finances, the assessment has also taken into account the adverse employment impacts of the decisions taken during the government term.[14]

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 −222 to +502 million. In view of fiscal policy, the most significant structural employment measure taken by the Government so far is the decision taken in December 2020 to gradually remove the right of additional days of unemployment security.

When the employment measures decided so far are assessed in relation to the debt path presented in the sustainability roadmap of spring 2021, it should be noted that the raising of 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. Therefore, the share of the decided employment measures remains at about EUR −68 to +388 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 of last spring estimates the impact of employment measures on public finances to be EUR 1 to 2 billion. In autumn 2021, the Government announced that a decision on an employment package to strengthen public finances by EUR 110 million would be made by 15 February 2022.

However, the decisions and guidelines related to the budget for 2022 contain a number of proposed measures that are in the right direction in view of strengthening the long-term growth potential of the economy. For example, the extension of the right to depreciate investments in machinery and equipment to 2024–2025 and the additional tax deduction right for companies in 2022–2027 concerning certain research and development expenditure can contribute to an increase in investments. Ensuring an adequate level of investments will be a critical factor to the future success of the national economy. Speeding up the immigration of skilled people can help to prevent the decrease in the workforce and human capital of the Finnish economy. The proposed fast lane for work permits and reinforcement of the resources in the immigration process may contribute to the achievement of this objective. In addition, the reform of compulsory education, which was decided previously and is already in force, may help to prevent a decline in human capital in the long term.

It must be ensured that the debt ratio target set in the sustainability road map is achieved

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. 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 NAOF's fiscal policy monitoring considers this to be a justified objective.[15] The basic premises of the sustainability roadmap changed then to some degree from autumn 2020, as the economic outlook improved. The level of improvement of public finances that is required to stabilize or reverse the development of the debt ratio decreased substantially. This brought the objective set out in the sustainability roadmap closer

In line with the opinions expressed by the NAOF's fiscal policy monitoring in 2020, the sustainability roadmap was supplemented in spring 2021 with 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 presented 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 not been updated in autumn 2021, but the general government outlook has continued to improve slightly. The long-term sustainability gap estimate, in turn, has improved in such a manner that the Ministry of Finance estimates the sustainability gap based on the S2 indicator to be around 3% in autumn 2021, while it was around 4% in spring 2019. Changes in the calculation technique have affected the development of the estimate during this period. In addition to other materials, it is useful to take the sustainability assessment into account when assessing the need for structural reforms with long-term impacts.[16]

It is necessary to prepare for the fact that the need to strengthen public finances may continue to change substantially as the economic outlook changes. The need for strengthening may thus also increase. In the future, the sustainability roadmap should also include a clearer assessment of the existing concrete plans or decisions to stabilize the debt ratio (or to achieve a downward trend, which would support the ability of public finances to cope with potential future crises) and an assessment of the further measures needed.

1.4 The economic forecast on which the budget is based is realistic

In its autumn 2021 forecast, the Ministry of Finance projects that the gross domestic product, describing the development of Finland's total output, will grow by 3.3% in 2021, 2.9% in 2022, and 1.4% in 2023. The median GDP forecast of other forecasters of the Finnish economy[17] is 3.3% for 2021, 3.0% for 2022, and 1.7% for 2023[18]. Figure 13 illustrates the forecast of the Ministry of Finance, the minimum–maximum interval calculated based on the forecasts of other forecasters, and the 95% confidence interval. The economic growth spurt in 2021–2022 is forecast to remain temporary, and economic growth is forecast to be closer to the expected long-term growth in 2023.

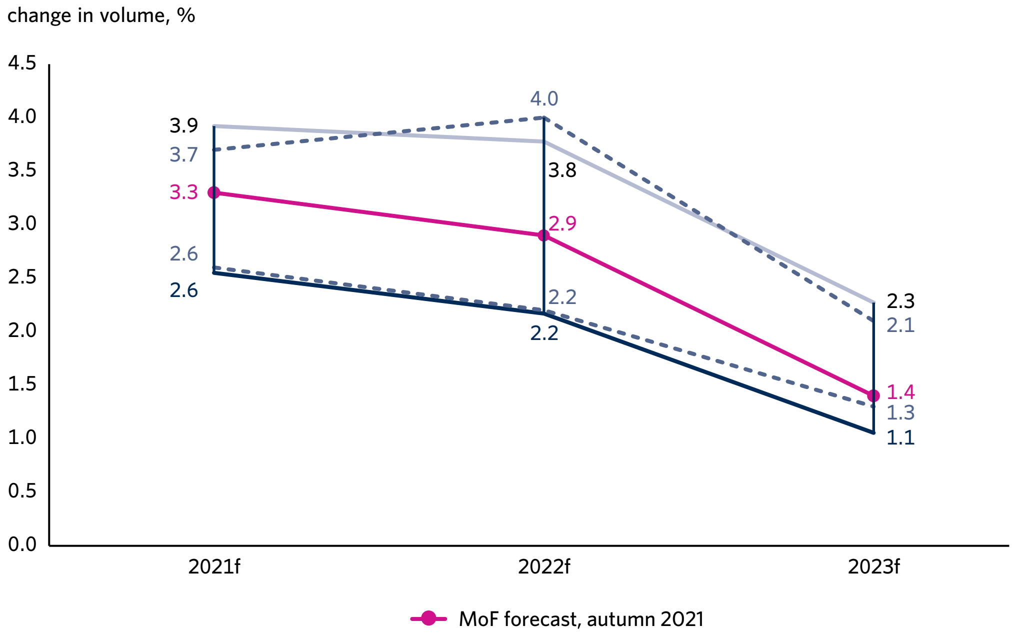

Figure 13: Distribution of GDP forecasts. Source: Forecasters and NAOF.

Table 2 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: (a) the minimum–maximum interval formed by picking the most optimistic and pessimistic estimates from the forecasts of the other actors, (b) the prediction interval based on the mean of the other forecasts, and (c) the prediction interval that takes into account the publication dates 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. However, it should be observed that the most optimistic or pessimistic forecaster may ultimately prove to be closest to the truth.

Table 2: 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, formed of the forecasts of the other economic forecasters, (b) the 95% prediction interval, and (c) the 95% prediction interval that takes account of the publication dates of the forecasts.

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, %	0	3	2
Exports, change in volume, %	3	3	3
Investments, change in volume, %	3	3	3
Unemployment rate, % of labour force	3	3	3
Employment rate, % of population	3	3	3
Inflation, %	3	3	3
Current account, % of GDP	1	2	2
Government fiscal balance, % of GDP	3	3	3
Government gross debt, % of GDP	3	3	3

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. Source: forecasters and NAOF.

The forecast of the Ministry of Finance is largely in line with those of the other forecasters, particularly in the case of 2022. The forecast on which the state budget is based is therefore realistic as a whole.

However, the Ministry of Finance's forecast of public consumption differs from those of the other actors for 2021. It exceeds the minimum–maximum interval formed of the forecasts of the other forecasters and both the 95% confidence interval that is based on the mean and the one that takes into account the publication dates of the forecasts. However, the Ministry of Finance's forecast falls only slightly outside the 95% confidence interval that takes into account the dates of the forecasts (Figure 14) and is within the 99% confidence interval. The Ministry of Finance assesses[19] the growth of public consumption expenditure to accelerate in 2021 due to the Covid-19 pandemic and the fight against it.

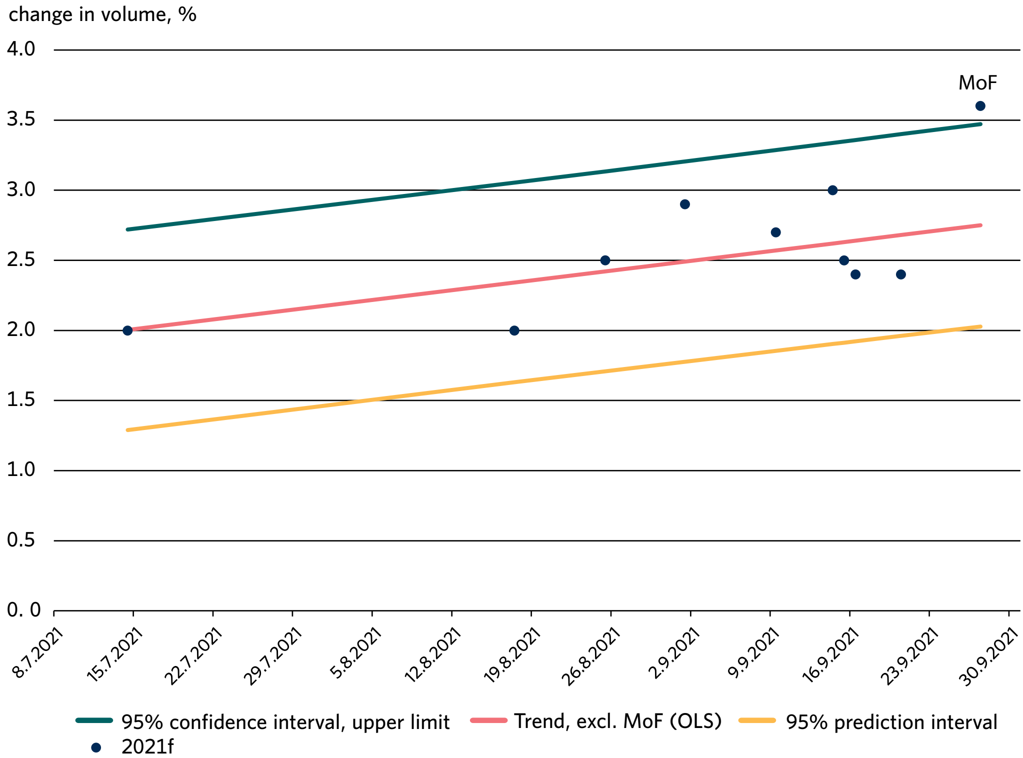

Figure 14: Forecasts of public consumption and the 95% prediction interval that takes into account the publication dates of the forecasts

The deviation in the current account shown in Table 2 is due to the fact that the Ministry of Finance has the most pessimistic current account forecast for 2021 and 2022. In its recommendation of 15 December 2020[20], the European Central Bank has urged credit institutions to exercise extreme prudence in dividend distribution for the financial years 2019–2020 until 30 September 2021. The Ministry of Finance estimates that this lifting of dividend restrictions will result in an increased payment of dividends abroad, which will reduce the surplus in one of the current account components, i.e. factor incomes and income transfers. It is not known how the other forecasters have taken into account the lifting of the dividend restrictions in their forecasts.

2 The future of EU fiscal rules is open

The general escape clause of the EU fiscal framework, activated in spring 2020, remains in force until the end of 2022. It allows Member States to deviate from the objectives set for their general government finances. The EU is discussing amending the fiscal rules before the escape clause is deactivated.

A number of options for amending the rules have been proposed in the public debate. All these proposals aim to overcome the problems or shortcomings identified with the current rules, such as poor compliance with the rules as well as their partial pro-cyclicality and complexity. An analysis of the proposals presented so far shows that amendments of the rules may change the conclusions on, for example, whether the projected development of Finland's debt ratio in this decade meets the requirements set by the rules.

Some of the proposals seek to take into account the need for investments related to combating climate change, for example, or the need for adequate investments in general. The problems with the current rules are reflected particularly in the uncertainty related to the calculation of the general government structural balance. Structural balance describes the general government fiscal position without the impact of the business cycle and one-off measures. When structural balance data calculated using two different cyclical adjustment methods are compared, very different conclusions are sometimes arrived at regarding the development of public finances and even compliance with fiscal rules. The cyclical adjustment calculated on the basis of the NAOF's business cycle indicator reacts faster to cyclical changes than the common cyclical adjustment method of Member States and the Commission. This underlines the need to assess the business cycle comprehensively by means of complementary methods.

2.1 The general escape clause of the EU framework remains in force in 2021 and 2022

On 20 March 2020, the Commission published a communication[21] on the activation of the general escape clause of the Stability and Growth Pact, because a severe recession was expected following the Covid-19 pandemic. The Finance Ministers of Member States supported the Commission's assessment concerning the activation of the escape clause. The activation of the general escape clause allows for a temporary deviation from the adjustment path towards the medium-term objective set for the public finances of each Member State, provided that this does not jeopardize the sustainability of public finances over the medium term. On 17 September 2020, the Commission announced in its Annual Sustainable Growth Strategy[22] that the general escape clause will remain active in 2021. The criterion for the deactivation of the escape clause is the level of economic activity in the EU or in the euro area compared with the pre-crisis level (end of 2019). According to the Commission's spring 2021 forecast, the pre-crisis level of economic activity will be achieved in 2023. This means that the escape clause will remain active in 2022 and that it is now expected to be deactivated at the beginning of 2023.[23]

> The European Commission has emphasized the need to pursue an expansionary fiscal policy.

On 3 March 2021, the Commission published a communication[24] providing further policy orientations to facilitate the coordination of fiscal policies and the preparation of Member States' Stability and Convergence Programmes. Taking into account the budgets of Member States and the Recovery and Resilience Facility, the overall fiscal impulse should remain supportive in 2021 and 2022. Especially Member States with low sustainability risks should gear their budgets towards maintaining a supportive fiscal policy in 2022. Finland is one of the Member States whose sustainability risks in the medium term are low according to the recommendation of the EU Council.

On 2 June 2021, the Commission published a report under Article 126(3) of the TFEU. The report deals with Finland's general government finances. In 2020, Finland's general government deficit exceeded the 3% reference value set by the Treaty, and its general government debt exceeded the 60% reference value relative to GDP and did not fall sufficiently rapidly. It was stated in the report that Finland had not complied with the deficit and debt criteria.

In its assessment of the 2021 Stability Programme of Finland, issued on 18 June 2021[25], the Council of the European Union recommended Finland to maintain a supportive fiscal stance in 2022, including the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment. The Council also recommended that, when economic conditions allow, Finland should pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions and ensuring fiscal sustainability in the medium term, while enhancing investment to boost growth potential. The Council also stated that more precise quantified guidance for the later years should be provided in 2022, if the degree of uncertainty has declined sufficiently by then.

If the escape clause is deactivated in 2023 and the requirements of the current framework are reinstated, it can be assumed on the basis of the Stability and Growth Pact and national fiscal legislation that the structural balance should improve by 0.5% relative to GDP. Based on the draft budgetary plan and the Ministry of Finance's independent forecast, the improvement of the structural balance would be in line with the required adjustment (Figure 15). However, structural balance estimates involve considerable uncertainty – especially when the economic cycle is turning. In its autumn 2021 estimate of structural balance, the Ministry of Finance has estimated based on the macroeconomic forecast that in 2024 and 2025, the Finnish economy will be neither in a downward nor in an upward cycle (the output gap has closed, i.e. is zero), whereby there will be no difference between the structural balance and the deficit (i.e. nominal balance). This will also affect the structural balance estimate for 2023.

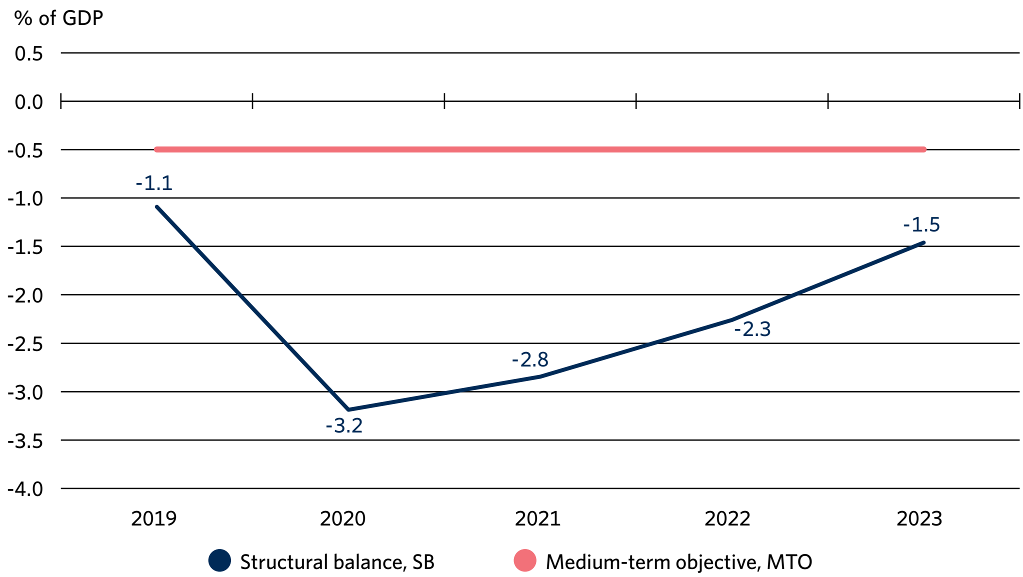

Figure 15: Structural balance and Finland's medium-term objective (MTO) Source: Ministry of Finance, Economic Survey, Autumn 2021.

The Ministry of Finance forecasts that the nominal fiscal position will be –1.5% in proportion to in 2023, i.e. that the deficit would be below the 3% limit. On the other hand, the forecast debt ratio of 72.2% to GDP in 2023 would exceed the limit of 60% to 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" to assess 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 of the Ministry of Finance, 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 criterion has been exceeded because of business cycles. This is done by calculating the "cyclically adjusted debt". The current estimate of the cyclically adjusted debt is 74.2% in proportion to 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. If all the three criteria were breached, the Commission would issue a report under Article 126(3) of the TFEU. In assessing breaching of the debt criterion, the report would take into consideration all relevant factors, e.g. whether the Member State has complied with the preventive arm of the Stability and Growth Pact. If a Member State's debt ratio exceeds 60% (having been below 60% in the previous year), the Commission always draws up a report under Article 126(3).

20 March 2020

The Commission issued a communication on the activation of the general escape clause of the Stability and Growth Pact.

23 March 2020

The Finance Ministers of Member States supported the Commission's assessment concerning the activation of the escape clause.

13 July 2020

According to the Council Recommendation on the economic policy of the euro area, all euro area Member States should continue to pursue an expansionary fiscal policy throughout 2021, policy measures should be tailored to the circumstances of each country, and they should be timely, temporary, and targeted.

20 July 2020

The Council recommended that, taking into account the general escape clause, Finland should take all necessary measures to combat the pandemic, maintain the economy, and support the recovery that has begun. It also recommended that, when the economic conditions allow, Finland should pursue a fiscal policy aimed at achieving a prudent medium-term fiscal position and ensure fiscal sustainability while increasing investments.

17 September 2020

The Commission announced in its Annual Sustainable Growth Strategy that the general escape clause will remain active in 2021.

3 March 2021

The Commission issued the communication *One year since the outbreak of COVID-19: fiscal policy response*, setting out further guidelines to facilitate the coordination of fiscal policies and the preparation of Member States' Stability and Convergence Programmes. Taking into account the budgets of Member States and the Recovery and Resilience Facility, the overall fiscal impulse should remain supportive in 2021 and 2022. At the same time that economic activity is expected to gradually normalize in the second half of 2021, Member States' fiscal policies should be further differentiated in 2022. Especially Member States with low sustainability risks should gear their budgets towards maintaining a supportive fiscal policy in 2022, taking into account the impacts of the Recovery and Resilience Facility. Finland belongs to this group.

The Commission also stated that the decision to terminate or extend the application of the general escape clause should be based on an overall assessment of the state of the economy. The key quantitative criterion in this assessment should be the level of economic activity in the EU or the euro area as compared with the pre-crisis level (end of 2019).

2 June 2021

On the basis of its economic forecast of spring 2021, the Commission considered that the conditions for the extension of the application of the general escape clause to 2022 and for its deactivation in 2023 were fulfilled. Country-specific situations will continue to be taken into account when the general escape clause has been deactivated.

The Commission issued a report under Article 126(3) of the TFEU. The report deals with Finland's general government finances, since in 2020 Finland's general government deficit exceeded the 3% reference value set by the Treaty, and its general government debt exceeded the 60% reference value relative to GDP, and government debt did not fall sufficiently rapidly. It was stated in the report that the deficit criterion and the debt criterion have not been complied with.

18 June 2021

The Council recommended Finland to maintain a supportive fiscal stance in 2022, including the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment. The Council also recommended that, when economic conditions allow, Finland should pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions and ensuring fiscal sustainability in the medium term, while enhancing investment to boost growth potential.

19 October 2021

The European Commission issued the communication *The EU economy after COVID-19: implications for economic governance*, which deals with economic governance now that the circumstances have changed because of the Covid-19 crisis. At the same time, a public debate is launched on the review of the regulatory framework of the EU's economic governance system.

Figure 16: Timeline of the phases of EU fiscal guidance during the Covid-19 pandemic.

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 review of the effectiveness of the economic surveillance framework was published and a public debate of its future was launched in February 2020. Due to the Covid-19 pandemic, consultation on the reform of the framework has been on hold. On 19 October 2021, the European Commission published a communication[26] on the relaunch of the public debate on the review of the EU's economic governance framework. The aim is to reach an agreement on the way forward in good time before 2023. The European Fiscal Board[27], which acts as the independent advisory body of the European Commission, has even considered it counterproductive if the rules were reinstated without being actually reformed when the escape clause is deactivated.

Assessment of the structural situation of general government in 2021 depends heavily on the choice of the cyclical adjustment method

The method jointly agreed by Member States for assessing the business cycle is based on the output gap calculated using the production function method. The method has been criticized for functioning poorly, especially in connection with cyclical changes. Therefore, the method often gives the impression that a period of economic downturn still continues, even though an upturn has already commenced and vice versa. The business cycle estimate provided by the method is revised afterwards when statistical data on labour force, capital base, and productivity become more accurate.

One possibility of producing a more up-to-date assessment of the business cycle is the composite indicator of the economic heatmap produced by the NAOF's fiscal policy monitoring. The composite indicator is formed from different business cycle indicators. The advantage of the composite indicator is its ability to observe the business cycle in a timely manner, i.e. it is revised only to a minor degree afterwards. It is therefore a good additional tool to be used in parallel with the output gap for measuring the business cycle[28].

Figure 17 shows that the composite indicator produced by the NAOF provides a fairly similar picture of the business cycle as the output gap that has been produced by Member States' common methodology and that has been revised based on specified statistical data. On the other hand, at the time of fiscal policy-making (i.e. in the spring preceding the budget year), the output gap may provide a misleading picture of the business cycle, especially when there are cyclical changes. This has been the case, for example, in spring 2016 and 2017, when the picture of the business cycle of the following budget year was too pessimistic (the output gap for 2017 and 2018 was estimated in the spring of the previous year to be negative but was found ex post to be positive). The use of the composite indicator and its forecast might have provided an accurate picture of the business cycle in real time for the years in question.

> The business cycle should be assessed comprehensively, especially when there are cyclical changes.

As regards 2021 and 2022, the composite indicator of the NAOF's fiscal policy monitoring and its forecast provide a different picture of the business cycle than the output gap. Based on the composite indicator and its forecast, the economy is in an upturn phase and above the medium-term average in 2021 and 2022, whereas based on the output gap, it is still below the estimated potential output despite an upturn. The difference in the assessments of the business cycle may also be partly due to temporal differences in their knowledge base: The NAOF's business cycle assessment is based on new data available at the end of October 2021, whereas the primary balance and output gap estimates are based on data on the economic situation at the end of the summer.

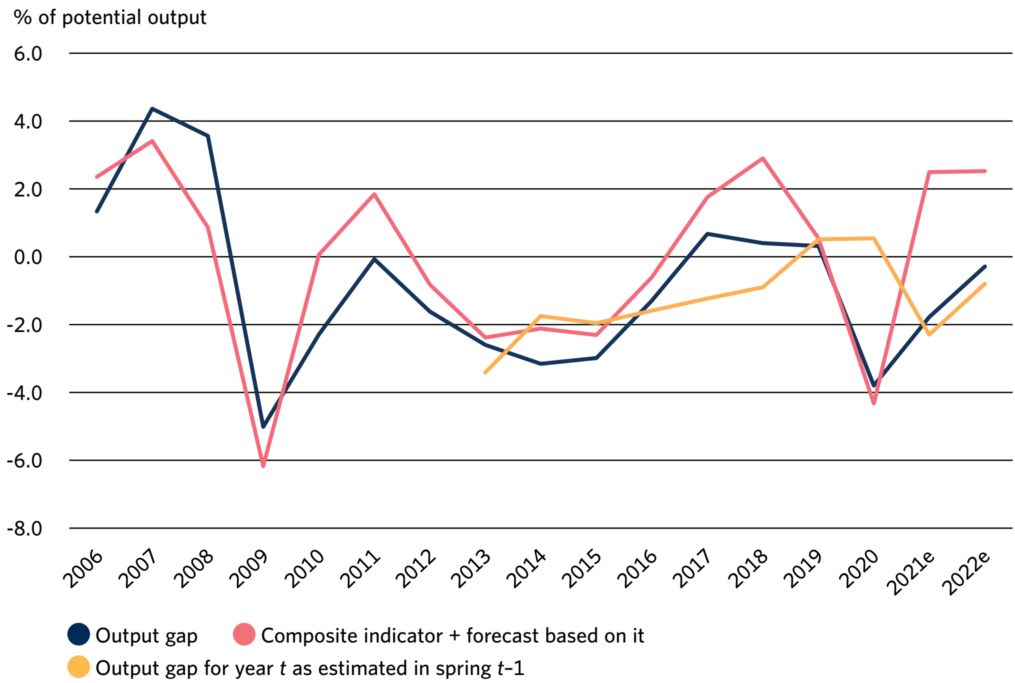

Figure 17: Output gap based on Member States' common methodology and the NAOF's composite indicator. Source: MoF and NAOF.

Because these two different methods (the NAOF's composite indicator and its forecast, and Member States' output gap) provide a different picture of the business cycle in 2021 and 2022, there is a significant difference in the cyclically adjusted general government structural balance, depending on the cyclical adjustment applied.[29] Figure 18 shows that, based on the output gap, the structural balance begins to improve already in 2021, whereas based on the NAOF's composite indicator, it continues to deteriorate and will improve only in 2022.

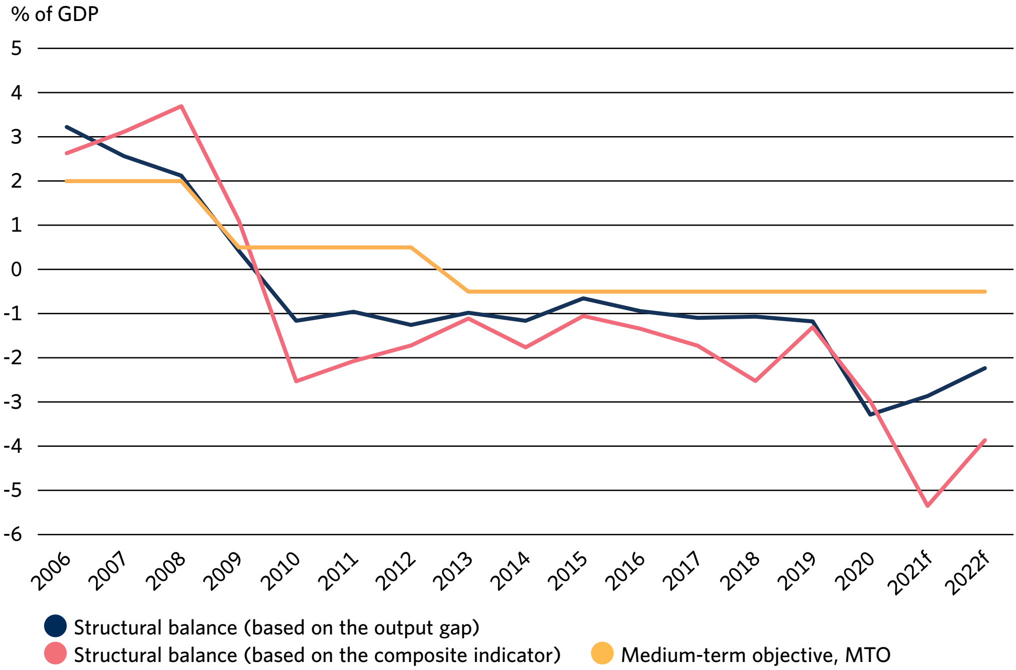

Figure 18: General government structural balance estimated based on the NAOF's composite indicator and its forecast and on the output gap. Source: MoF and NAOF.

2.2 There are several options for amending the EU rules

The growing debt ratios have intensified the debate on the future of the fiscal rules. In the proposals of several expert bodies, the aim of the new rules should be to achieve the country-specific debt ratio objective or debt reduction rate by limiting the growth of general government net expenditure. The proposals are largely based on amending the current rules of the Stability and Growth Pact[30]. In the most radical proposals, the current rules would be abandoned completely and replaced with country-specific standards, which would give more room for analysis and interpretation of the Member State's economy[31]. On the other hand, emphasis has been placed on promoting investments by allowing exceptions to cost control, for example through investing in combating climate change, education, and digitalization[32]. These proposals are not formal proposals by Member States. On 19 October 2021, the European Commission resumed the debate on reforming the rules and published a questionnaire that is open to all. The responses will be used in the consideration of further measures.

Reforming the rules as proposed by the European Fiscal Board would reduce the need to adjust Finland's public debt in the next few years

Even before the Covid-19 pandemic, the European Fiscal Board proposed focusing on the expenditure benchmark instead of the structural balance. The aim of the proposal is to reduce debt ratios in such a manner that a Member-State-specific expenditure benchmark would lead in the long term to the achievement of the country-specific debt ratio target.

At present, all Member States have the same limits for both general government debt (60% in proportion to GDP) and deficit (3% in proportion to GDP). The Member States complying with these limits are in the preventive arm of the Stability and Growth Pact. In this case, the Member State is bound by the medium-term objective for the structural balance. The achievement of this objective is assessed based on two different criteria: structural balance and expenditure benchmark.

According to the Committee, focusing on the expenditure benchmark and the debt ratio objective would simplify the framework and make it easier to communicate. Above all, the expenditure benchmark could lead to a counter-cyclical fiscal policy, smoothing cyclical fluctuations, better than the current rules.

The proposed expenditure benchmark could include a 'limited golden rule', which would mean that certain well-defined and nationally financed additional investments supporting growth would be excluded from the expenditure benchmark.[33] However, for several reasons, it is not simple in practice to define investments supporting the growth potential of the economy. For example, research and development expenses are widely understood to be such investments, and in the national accounts they are classified as capital-generating investments. Education expenditure, healthcare and social welfare expenditure, and expenses for combating social exclusion, in turn, are not defined as investments in the national accounts, even though they can also be deemed to have positive impacts on economic growth.

A limited golden rule of this kind could also apply only to investments in the green transition (green golden rule). In Finland, however, municipally owned energy companies that make significant green investments are included in non-financial corporations in the national accounts. Therefore, their investments in renewable energy production would not fall within the scope of such a green golden rule applied to public expenditure – unless investment grants awarded by central or local government were used for the investment. In that case, the rule could contribute to an increase in general government investment grants.

In its 2021 report, the Board has decided to propose an alternative to the limited golden rule for increasing national investments to promote the green and digital transition. The Board proposes that Member States' contribution to the EU budget should be increased but that the same funds should be provided to Member States for investments supporting the green and digital transition. The Board is of the opinion that, compared with the golden rule, this would make it easier to ensure sufficient coordination of national measures to meet the agreed climate objectives, for example.

In addition, the various elements of flexibility in the current framework would be replaced by a general escape clause, which would be activated on the basis of an analysis independent of policymakers, in a similar way that the general escape clause of the Stability and Growth Pact has been activated.

With the current outlook for economic growth, interest rates, and debt, the expenditure benchmark proposed by the European Fiscal Board would allow Finland to adjust its debt more slowly than required by the debt reduction rule of the Stability and Growth

> The estimate of the development of Finland's debt ratio based on the current forecast would meet the EFB proposal's requirements in the current decade.

Pact (Figure 19). If the rules laid down in the Stability and Growth Pact were reinstated in 2023, Finland's general government debt should fall to 71% in proportion to GDP by 2025, whereas the current forecast of the Ministry of Finance for general government debt is 73.4% to GDP in 2025. The debt criterion under the Stability and Growth Pact would thus require a one-off adjustment of EUR 6.9 billion in 2025 (at the 2025 price level) — unless the adjustment had been started earlier. The proposal of the European Fiscal Board on the expenditure benchmark and the related debt path, in turn, would allow Finland to adjust its debt more slowly. According to the proposal, the debt ratio would even be allowed to grow in the current decade until it should start to decrease in the 2030s. According to the Ministry of Finance's forecast and sustainability gap calculation, the estimated debt ratio (with the current interest rate and growth outlook) would meet the debt ratio according to the proposal in this decade but no longer in the 2030s.

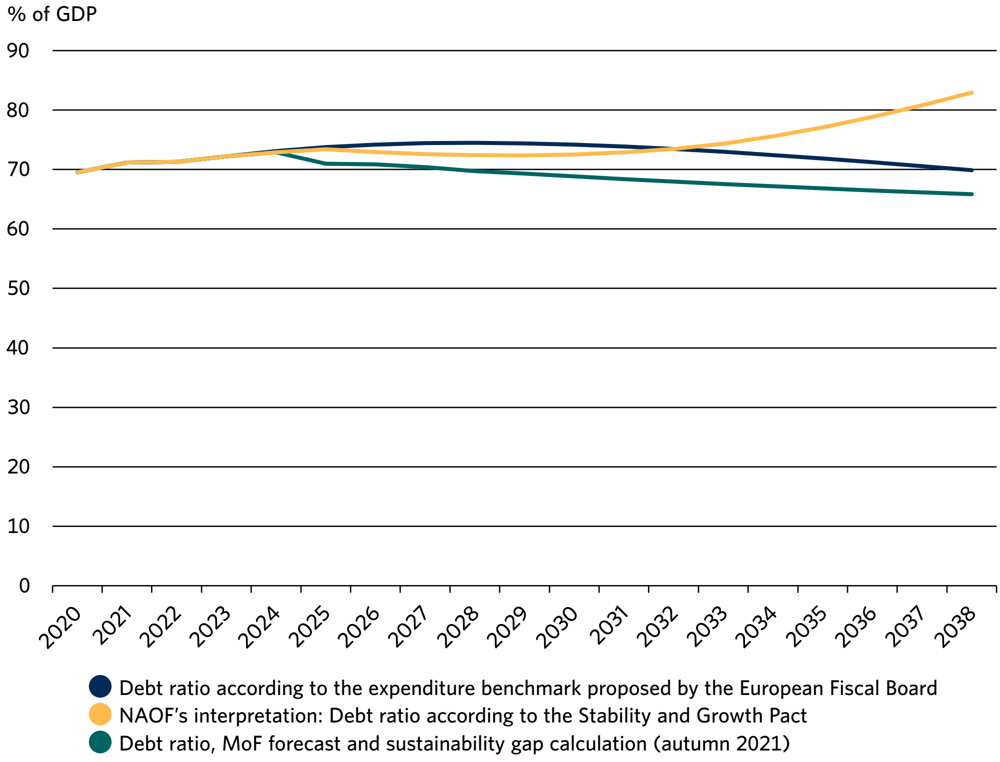

Figure 19: Finland's public debt ratio according to the expenditure benchmark proposal by the European Fiscal Board, according to the Stability and Growth Pact, and according to the Ministry of Finance's forecast and sustainability gap calculation. Source: European Fiscal Board (2018, 2020), Ministry of Finance's Economic Survey and sustainability gap calculation (Autumn 2021), Vade Mecum (2018). (1) The calculation assumes that the long-term nominal interest rate is 3.1% and the economy will grow at the potential level, i.e. by 3% annually. The limited golden rule has not been taken into account in the calculation. (2) The debt path according to the Stability and Growth Pact has been calculated on the assumption that until 2024, the debt ratio may develop according to the Ministry of Finance's autumn 2021 forecast, the debt ratio for 2025 has been calculated on a forward-looking basis, and the debt ratio required from 2026 onwards has been calculated on a backward-looking basis.

The golden rule of the European Fiscal Board's proposal and its impact on debt can be illustrated by the following example. If it is assumed that the 10-year average of publicly funded R&D expenditure is 1% of GDP and public R&D investments in 2023 are 1.5% of GDP, the additional investments "attracted" by the golden rule would amount to 0.5% of GDP (1.5% – 1% = 0.5%). In this case, Finland would be allowed to exceed the expenditure benchmark by 0.5% relative to GDP.[34] At the same time, the government debt-to-GDP ratio would increase. The idea is that additional investments increase the growth potential of the national economy, which over time would lead to a reduction in the government debt-to-GDP ratio. However, it should be noted that this would not necessarily happen and that additional investments would not necessarily change the economic growth. In this case, the public debt ratio would continue to grow. The Board has pointed out that this possibility should also be taken into account in the framework and, should this be realized, the debt adjustment requirement should be tightened. This would require a statement on the pace at which investments should be reflected in economic growth.

EU fiscal institutions call for clear and carefully prepared rules

The Network of Independent EU Fiscal Institutions has published a paper[35] on the development of EU fiscal governance. National fiscal institutions, such as the National Audit Office of Finland, are independent, non-partisan expert organizations. They are part of the EU fiscal governance framework, and their statutory tasks include applying and assessing the rules.

According to the working group that prepared the paper, the current EU governance framework suffers from three main interrelated problems: weak compliance, pro-cyclicality, and excessive complexity. Complexity contributes to weak compliance and ineffective enforcement, which can lead to pro-cyclicality.

The working group does not present a separate proposal for a new framework but underlines the need for numerical rules based on a simple, transparent, and multi-annual approach. The rules should aim to reduce risks from high government debt-to-GDP ratios. In addition, the rules should be planned carefully and tested by simulation.

The working group also discusses data and indicators supporting the monitoring and assessment of public finances. The working group proposes, for example, that net debt and net asset statistics and related forecasts should be used in the future to improve and supplement the assessment of the debt situation. The current fiscal governance framework deals with debt only as a gross concept, without taking into account general government receivables. According to the working group, net indicators could improve and broaden the picture of general government finances. The concept of net debt describes the ability of general government to meet its financial liabilities more comprehensively than the gross concept. Net debt concepts can be defined by deducting either all or only liquid financial assets from debt.

> The rules should support debt sustainability.

In practice, the difference between the concept of net debt and the concept of gross debt is, for example, that the sale of financial assets (e.g. the sale of dividend-generating shares) to finance current expenditure does not affect gross debt but weakens general government net debt. Correspondingly, assets acquired with debt are reflected in the increase in gross debt although they do not necessarily impair the financial wealth position of general government.[36]

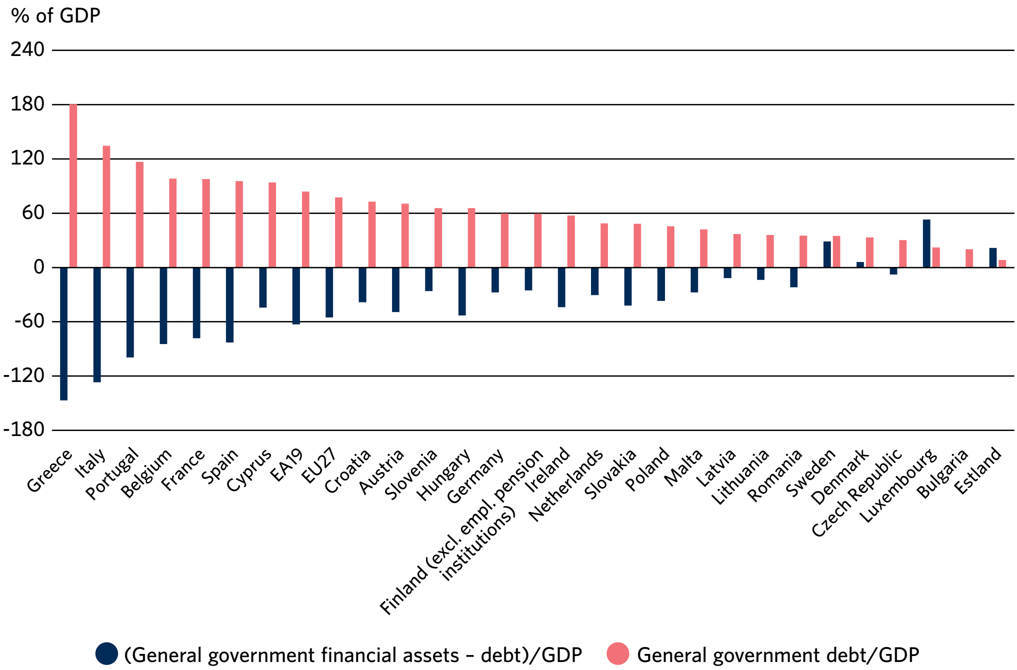

Figure 20: The ratio of net debt (financial assets–debt) to GDP and the ratio of debt to GDP, EU27, euro area 19, and Member States, 2019. The data for Finland does not include the financial assets of employment pension institutions. Source of the figure: Eurostat and Statistics Finland

The statistics that the OECD publishes for its member countries already include a net debt indicator. Corresponding statistics for the European countries can be found in Eurostat data. Figure 20 shows the debt-to-GDP ratio of the EU countries from the highest to the lowest and the net debt-to-GDP ratio. The indicators describe the comparative position by country almost identically. The ranking of the countries is very similar in both indicators. The value of the Pearson's order correlation coefficient, describing the order of the countries, is 0.94. Figure 21 shows the development of gross debt and net debt indicators in the euro area from 2000 onwards.

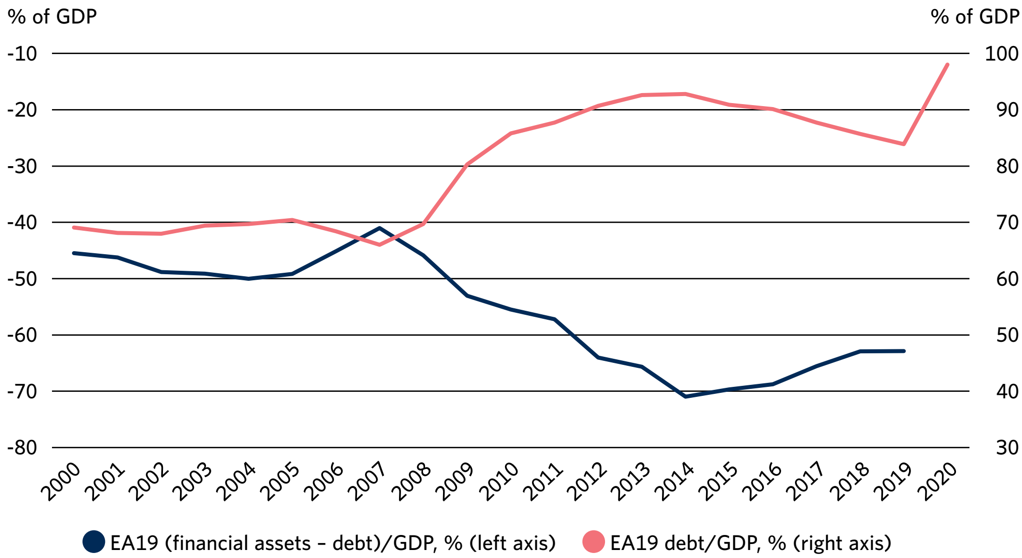

Figure 21: (Financial assets–debt)/GDP and debt/GDP, euro area in 2000–2020 Source: Eurostat

Like other actors[37], the working group recommends strengthening the roles of national fiscal institutions. National fiscal institutions have a special opportunity to take national features into consideration when assessing fiscal policy, and their opinions should be taken into account when compliance with the rules is assessed by the EU bodies. The working group underlines that a conclusion on the rules to be followed in the future should be drawn by 2023. Numerical rules would make it easier to respond to the challenges public finances will be facing once the exceptional circumstances due to the Covid-19 pandemic cease to apply. A long period of exceptional circumstances, in turn, could expose countries to unsustainable fiscal policy management.

3 The importance of national fiscal policy steering instruments will be emphasized when normal times are restored

The objectives set for public finances in the General Government Fiscal Plan of spring 2021 are broad but meet the requirements laid down in legislation. At present, their fiscal policy steering impact is weak. The General Government Fiscal Plan was completed only on 12 May 2021, which is not in compliance with the deadline laid down in the decree. Furthermore, in anticipation of the establishment of wellbeing services counties, the monitoring of the limit on local government expenditure was abandoned in the Plan, although no decisions have yet been made of the future of the expenditure limit. Therefore, fiscal legislation has not been fully complied with.

Both national and EU legislation emphasize the strengthening of public finances when the exceptional circumstances cease to exist. In the fiscal planning for 2023, it would therefore be justified for the Government to place great emphasis on the rule-based need for strengthening, so that any new tax and expenditure decisions for 2023 are in line with the need for strengthening in net terms. The current decisions and outlook are likely to strengthen public finances as referred to in fiscal regulation.

Central government spending limits expenditure has increased considerably during the parliamentary term. This has been enabled by the decision to dispense with the spending limits in 2020 and the exceptions and increases made to the spending limits as from 2021. Many of the changes have been related to the Covid-19 pandemic. The increase in spending limits expenditure is partly due to the flexibility that was already included in the Government Programme and the original spending limits decision. An example of the flexibility is the application of the new mechanism for exceptional circumstances. On the other hand, the decisions taken in spring 2021 to raise the spending limits in 2022 and 2023 clearly violated the principles of the spending limits system. It is important that the spending limits system will continue to serve as a credible tool for long-term planning of central government expenditure.

3.1 The objectives set for public finances in the General Government Fiscal Plan of spring 2021 were broad but in compliance with legislation

The General Government Fiscal Plan for 2022–2025 was approved by the Government and submitted to Parliament on 12 May 2021. This does not comply with 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.

At present, the fiscal policy steering impact of the target path set for general government finances is weak.

Appendix 1 contains observations of the NAOF's fiscal policy monitoring 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[38] expressed by the National Audit Office in 2020. The National Audit Office 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 (general government structural balance –0.5% in relation to GDP). Thus, the escape clause brings flexibility to the tightness of 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 in spring 2021 is very flexible (Figure 22). The General Government Fiscal Plan did not disclose on what grounds the target path had been selected. In practice, the target path was largely in line with the development according to the Ministry of Finance's independent forecast of spring 2021. The flexibility of the target path meant that, in practice, no new fiscal policy measures were needed to achieve it, in the light of the independent forecast of the Ministry of Finance. On the basis of the autumn 2021 forecast of the Ministry of Finance, the target path set in the spring would be achieved even more easily. Therefore, in practice, the medium-term objectives set for general government finances have currently a weak steering impact. A fiscal policy objective that currently has a stronger steering impact is the objective related to bending the growth curve of the debt ratio.

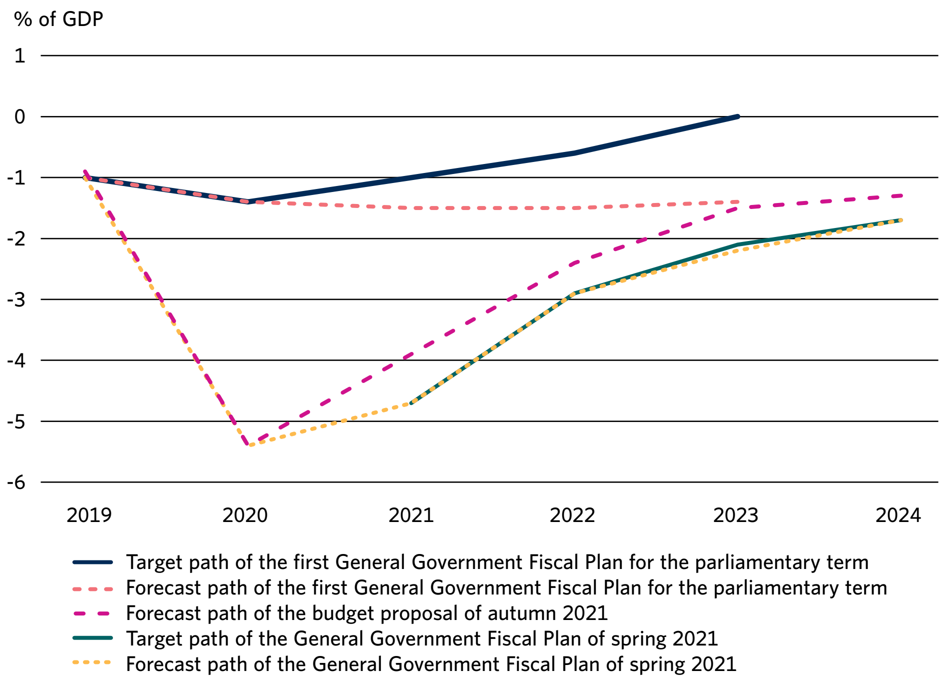

Figure 22: Target and forecast paths for the development of the nominal fiscal position of general government according to the first General Government Fiscal Plan of the parliamentary term, the General Government Fiscal Plan of spring 2021, and the budget proposal of autumn 2021. Source: General Government Fiscal Plans of autumn 2019 and spring 2021, and the Ministry of Finance's Economic Survey, autumn 2021.

In 2020, the NAOF's fiscal policy monitoring pointed out that fiscal legislation should be developed 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 fiscal policy monitoring regarded the decision as justified. However, it was also of the opinion 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, when the decree on the Plan is updated during the current year, it should also be assessed whether it is necessary to specify the fiscal legislation in so far as it deals with exceptional circumstances.

The objective set for the nominal fiscal position of local government for 2023 is –0.5% in relation to GDP. The Decree on the General Government Fiscal Plan stipulates that the Government shall set a limit in euros to the amount by which local government expenditure

> The expenditure limit set for local government finances by the decree has no longer been monitored in the General Government Fiscal Plan.

can increase due to central government measures. This limit is referred to as the expenditure limit for local government finances. The 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 the 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 its 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.

3.2 The Fiscal Policy Act emphasizes the strengthening of public finances when exceptional circumstances cease to exist

The Fiscal Policy Act[39], which implements the Fiscal Compact in Finland[40], contains provisions on a correction mechanism to be activated if the EU has detected a significant deviation in the development of the structural balance in Finland in relation to the objective set, and if the EU Council has recommended Finland to take corrective action. After the correction mechanism has been activated, the Government has to submit a report to Parliament and, at a possible further stage, a communication on measures to improve the general government finances. The Government does not have to issue a report or a communication if exceptional circumstances as referred to in EU legislation exist in Finland. After the exceptional circumstances cease to exist, the Government shall strengthen general government finances by at least 0.5 percentage points relative to GDP (in structural terms) no later than in the following calendar year, and the National Audit Office shall issue an opinion on the adequacy of the measures. In addition, after the exceptional circumstances have ceased to exist, the Government shall draw up the General Government Fiscal Plan in such a manner that the above-mentioned strengthening target of 0.5 percentage point is achieved.

In 2020, the EU decided that exceptional circumstances exist, and according to the Commission, the general escape clause will continue to apply in 2022[41]. Since the emergence of exceptional circumstances, the EU Council has not issued any recommendations to remedy significant deviations. Thus, the escape clause under section 4 of the Finnish

Fiscal Policy Act (869/2012) has not actually been applied so far, as the correction mechanism binding on the Government has not been activated due to the decision already taken by the EU on the general escape clause. Therefore, the Government would not have been obliged to report on corrective measures even if the Fiscal Policy Act did not contain provisions on exceptional circumstances.

However, the exceptional circumstances have affected the application of the requirement laid down in section 3 of the Decree on the General Government Fiscal Plan. The requirement concerns the Government's obligation to set multi-annual objectives for general government finances. In spring 2020, no multi-annual objectives were set, and the objectives set in spring 2021 were less strict than normal (see also section 3.1).

Fiscal policy legislation leaves room for interpretation as regards the cessation of exceptional circumstances. The obligations imposed on the Government after exceptional circumstances have ceased to exist are somewhat unclear compared with the provisions of the Fiscal Policy Act that concern the measures the Government is required to take in a situation where the EU Council has detected a significant deviation in the public finances of Finland and where the Council has recommended Finland to take corrective measures. A fundamental problem in legislation concerns the way in which exceptional circumstances have been incorporated intothe correction mechanism.

In practice, the provisions in the Fiscal Policy Act on the national correction mechanism mean, for example, that the national correction mechanism as referred to in section 3 of the Act will not be activated at all if the general escape clause has been activated at the EU level (as in connection with the Covid-19 crisis). This is because the binding correction mechanism provided for in national legislation can only be activated if the EU Council has recommended Finland to take corrective measures. In practice, the Council does not issue such a recommendation when the general escape clause is in force. Therefore, the significance of section 4 on exceptional circumstances in the Fiscal Policy Act is unclear. In the present situation (where the exceptional circumstances are likely to cease but where section 4 related to them has, in fact, not been applied), the ambiguity complicates the interpretation of the binding nature of section 5, linked to section 4, on the cessation of exceptional circumstances.

Another issue that is open to interpretation concerns the time when the corrective measures should be taken. The content of the Fiscal Policy Act and the Decree on the General Government Fiscal Plan easily leads to an interpretation that, under the Act, the actual window for taking the corrective measures is 2023–2024, provided that the exceptional circumstances continue to be in force until the end of 2022. However, this is ill-suited to the current outlook, where it is known well in advance, with reasonable certainty, that the exceptional circumstances will cease at the end of 2022, and it would therefore be justified and possible to prepare for corrective actions in advance. It is also foreseeable that 2022 will already in many ways be a year of strong recovery, although under EU law, it will

> From an economic point of view, it is justified to strengthen public finances more rapidly than required by legislation.

> The current decisions are likely to strengthen public finances as referred to in fiscal regulation.

continue to be a year of exceptional circumstances. From an economic perspective, the period 2023–2024 as defined in national legislation appears therefore to be unnecessarily flexible.

This uncertainty is increased by the current situation where it is unclear what kinds of fiscal rules will apply in 2023 when the escape clause ceases to be in force according to plan. The Commission has announced[42] that it will promote a possible reform of the rules so that a broad-based understanding can be reached in good time before 2023 (see also section 2.1). In the absence of more detailed information or decisions, it must be assumed that the obligations under the current Stability and Growth Pact, without the flexibility resulting from the exceptional circumstances, will be restored in 2023.

However, it is necessary to observe that national legislation and the Fiscal Compact are strongly linked to the concept of structural balance, which is defined in the preventive arm of the Stability and Growth Pact. A large part of the criticism of the current framework relates to the use of the structural balance, which has proved to be an uncertain indicator in several Member States (see also the findings concerning Finland in section 2.1). In its communication of 19 October 2021, the European Commission has also explicitly emphasized the importance of simpler rules based on observable economic variables.

In view of the above, it is not possible to draw detailed conclusions on compliance with section 5 of the Fiscal Policy Act at least at this stage. In any event, the ultimate purpose of the provisions contained in the Act is to strengthen public finances according to the requirements of the EU Stability and Growth Pact when the exceptional circumstances cease to exist[43]. This purpose is fulfilled by the current outlook for general government finances, according to which the structural balance will be strengthened significantly in 2023 (0.8 percentage points according to the independent forecast of the Ministry of Finance) and substantially already in 2022 (0.5 percentage points according to the independent forecast of the Ministry of Finance).

In order for the strengthening according to the purpose of the legislation to be achieved with sufficient certainty in 2023, the NAOF's fiscal policy monitoring is of the opinion that it would be justified for the Government to place great emphasis on the strengthening need in the fiscal planning for 2023. In practice, this means, for example, that any new tax and expenditure decisions for 2023 should be in line with the strengthening need in net terms. The NAOF's fiscal policy monitoring will monitor this in its forthcoming reports based on its assessment of the General Government Fiscal Plans and the draft budgetary plans, as well as other analyses.

3.3 Spending limits expenditure has increased during the parliamentary term

The Government sets four-year spending limits on budget expenditure at the beginning of the parliamentary term. Around 80% of central government budget expenditure falls within the scope of the spending limit. 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.

Expenditure falling within the scope of the central government spending limits system has increased during the current parliamentary term. Figure 23 shows the budgeting of expenditure falling within the scope of the spending limits system in the budgets from 2004 onwards at the 2020 price level. During the current parliamentary term, spending limits expenditure has reached a higher level than in the previous parliamentary terms.

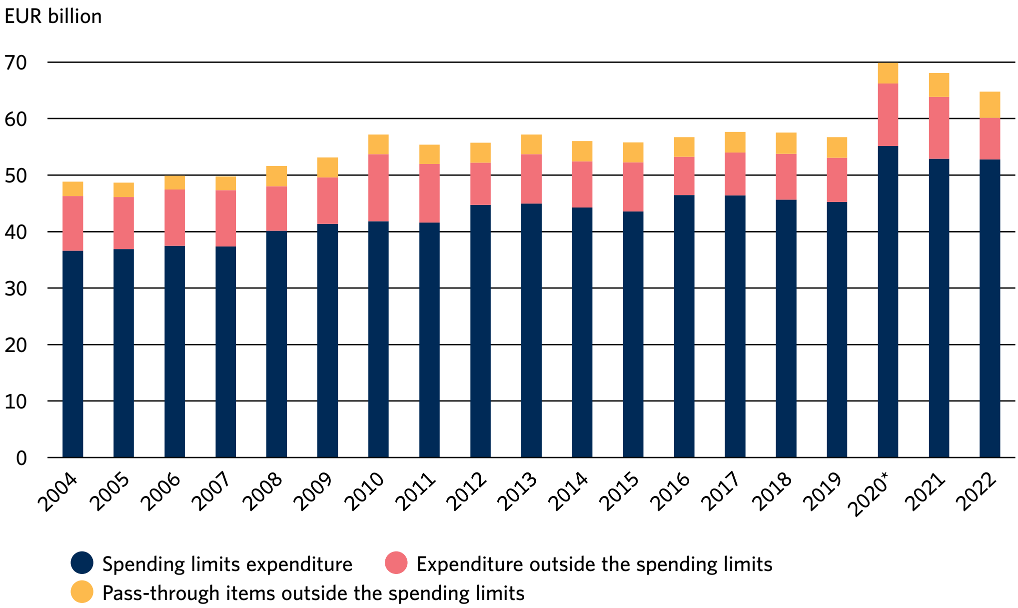

Figure 23: Spending limits expenditure and expenditure outside the spending limits in the budgets for 2004–2022 at the 2020 price level, excluding 2021 and 2022. *In 2020, the spending limits were not in force; the expenditure is based on the NAOF's estimate. Source: Ministry of Finance, budget data.

The increase in spending limits expenditure during the parliamentary term has been enabled by the decision to dispense with the spending limits in 2020 and the exceptions and increases made to the spending limits as from 2021. The room for manoeuvre introduced in the spending limits through exceptions and provisions has been utilized to a large extent in budgeting. Table 3 below summarizes the changes and exceptions to the spending limits of the parliamentary term following the Covid-19 pandemic.

Table 3: Changes and exceptions to the spending limits of the parliamentary term following the Covid-19 pandemic (EUR million).

Changes in the spending limits level	2020	2021	2022	2023
Mechanism for exceptional circumstances	-	500	500	-
Provision for one-off expenditure needs that arise from the Covid-19 situation and are mandatory in terms of fiscal policy	-	1,850	-	-
Rise or increase in spending limits level	8,437	-	900	500
Exceptions to the spending limits rule: Impacts of exceptional circumstances	-	424	176	155
Exceptions to the spending limits rule: Health security in the Covid-19 situation	-	1,967	6	35

Table 4 presents the calculation of the spending limits of the parliamentary term based on the technical spending limits of the previous Government. Expenditure increases and other changes made in the Government Programme have been included in the spending limits of the parliamentary term. The spending limits for the parliamentary term form the expenditure level that should be maintained throughout the parliamentary term. The spending limits principles should guide all subsequent adjustments made to the expenditure level.

Table 4: Calculation of the spending limits during the government term and changes affecting the spending limits by supplementary budget IV for 2021 and the supplementary budget proposal for 2022 (the spending limits of 2020 are not in force) (Source: Ministry of Finance, calculations by NAOF) (EUR million)

Calculation of the spending limits	2020	2021	2022	2023
Technical spending limits	**44,853**	**46,417**	**46,582**	**46,716**
Spending limits expenditure according to the Government Programme, total	2,058	2,884	2,518	1,400
— permanent additional inputs within spending limits expenditure	1,078	1,375	1,318	1,370
— permanent reallocations of spending limits expenditure	-50	-50	-125	-100
— one-off future-oriented investments (spending limits expenditure)	730	419	175	-
— provision for the financing of future-oriented investments	-	840	850	-
— supplementary budget provision	300	300	300	100
Transfer of compensations for tax revenue losses incurred by municipalities during the previous parliamentary term to the spending limits	1,012	1,012	1,012	1,012
Provision for unforeseen expenditure needs in 2020–2021	150	244	135	-
Spending limits of the parliamentary term (incl. the supple-mentary budget provision)	**48,073**	**50,557**	**50,247**	**49,128**
Structural adjustments, total	-1,341	2,112	642	13,276
Changes in justifications	-1,213	-266	-75	-79
Technical adjustments (timing change, re-budgeting, pass-through item, technical change)	-159	-78	689	12,987
Use of an unallocated reserve carried over from the previous year	31	-	-	-
Mechanism for exceptional circumstances	-	500	500	-
Provision for one-off expenditure needs that arise from the Covid-19 situation and are man-datory in terms of fiscal policy	-	1,850	-	-
Provision for future-oriented investments and other entities having an impact on structural and cyclical policy	-	105	-472	367
Price adjustments, total	-34	602	1,406	1,383
Change in spending limits	-	-	900	500
Spending limits of the parliamentary term, 2021 supplemen-tary budget and amendment to the 2022 budget proposal	**46,697**	**53,271**	**53,195**	**64,287**
Budgeted within the spending limits (by 2021 supplementary budget 4 and amendment to the 2022 budget proposal)	55,135	53,149	52,839	-
Unallocated	-8,437	122	356	64,287

> The use of the mechanism for exceptional circumstances in the years following the economic disruption could be specified.

Monitoring of the spending limits during the parliamentary term has been complicated by various provisions, the number of which is exceptionally high in 2021. In addition to the provision for future-oriented investments included in the Government Programme, the Government introduced in 2021 a provision for expenditure arising from the Covid-19 pandemic as well as a half a billion stimulus provision for the mechanism for exceptional circumstances. The purpose of the provisions and the mechanism for exceptional circumstances has been defined rather broadly, wherefore it is possible to use them for the same purposes. However, it is important that the use of the different provisions and the mechanism for exceptional circumstances is monitored as a whole.

The mechanism for exceptional circumstances should be targeted at expenditure that is essential for the recovery. It would be possible to report on its monitoring for example in budgets, in the same way as with other provisions. The mechanism for exceptional circumstances was activated in 2020, but additional appropriations were allocated only to the following years, as the spending limits were not in force in 2020. Thus, the stimulus enabled by the mechanism for exceptional circumstances was not targeted directly at the beginning of the severe economic disruption but only at the following years. Stimulus measures have also been justified in 2021 and may continue to be justified in 2022 as well. However, in the definition of the mechanism for exceptional circumstances, it might be useful to specify whether the economy should be in a state of severe disruption even in the years when the additional appropriations enabled by the mechanism are used.

The Ministry of Finance has monitored the use of the spending limits provision for one-off expenditure that arises from the Covid-19 situation and is mandatory in terms of fiscal policy. The provision seems for the most part to have been used for the increases in expenditure caused by the Covid-19 situation. The Covid-19 situation has been interpreted rather broadly to refer to the new need for appropriations during the pandemic, to the compensation for the decline in other sources of income, or to stimulus measures. The largest individual expenditure items have been the transfer to the State Guarantee Fund (EUR 650 million), the purchase of off-shore patrol vessels (EUR 120 million), and the event guarantee (EUR 80 million).

The Government Programme included a provision of EUR 1.7 billion for one-off future-oriented investments for 2020 and 2021. In connection with the budget proposal for 2021, the purpose of the provision was expanded to cover future-oriented investments and other entities having an impact on structural and cyclical policy. The provision has been reduced in the budgets for 2021 and 2022, and part of the provision for future-oriented investments has been transferred to be used in 2023. It seems that the provision will be used in full. Based on the General Government Fiscal Plan and budget reports, it has been difficult to obtain a coherent overall picture of the use of the provision, the interpretation of future-oriented investments, and the one-off nature of expenditure items.

The 2023 spending limits will be significantly affected by the start of the operations of the wellbeing services counties. The transfer of funding from municipal tax revenue to the wellbeing services counties will raise the spending limits by EUR 13.4 billion from 2023 onwards. After the change, the spending limits will cover around 46% of the total public expenditure instead of the previous 35%–40%. The change will also affect the allocation of expenditure within the spending limits in many ways. For example, central government transfers to local government will be transferred to the expenditure of the counties. In the section of the health and social services transfer calculations that is related to central government transfers to local government, a need for change was identified: the way in which the changes in the different calculation and determination factors have been taken into account as from 2023 should be revised. As a result of the revision, the estimated central government transfers to local government in 2023 will increase compared with the General Government Fiscal Plan 2022–2025. This amendment does not affect the overall spending limits but reduces the margin of manoeuvre within the 2023 spending limits. The health and social services transfer calculations are preliminary and will be specified in connection with the preparation of the General Government Fiscal Plan 2023–2026.

The spending limits can be changed during the parliamentary term by means of price and structural adjustments. Structural adjustments leave some room for interpretation. Structural adjustments have raised the spending limits particularly in 2021. Table 4 shows the most important justifications for structural adjustments. Within structural adjustments, changes in criteria are made when a government decision is taken to increase unemployment security, housing allowance, or social assistance, which fall outside the spending limits. Even when increases in expenditure take place outside the spending limits, the increased level of expenditure decided by the Government must be financed from the spending limits so that the taxpayers' burden remains at the same level during the government term.

In its report *Functioning of the central government spending limits system* 8/2021, the National Audit Office has criticized the fact that the Ministry of Finance has also interpreted cuts in the level of unemployment security, housing allowance, and social assistance as structural adjustments for adjusting the spending limits upwards. According to the interpretation, savings on expenditure outside the spending limits can be used for other expenditure within the spending limits. This practice cannot be directly derived from the spending limits principles. Ending this practice might be justified, as the savings impact of cuts in unemployment security, housing allowance, and social assistance is usually presented as an employment impact, the objective of which is to benefit public finances. The benefit remains limited if a savings decision is linked with a practice that raises the level of public expenditure.

During the government term, the spending limits have been raised by EUR 23 million per year because of the Government's proposal to raise the minimum age limit for the right of additional days of unemployment security. In addition, because of the estimated savings in social assistance and housing allowance following the Nordic labour market service model, the spending limits have been raised by more than EUR 6 million per year, while the additional unemployment security expenditure arising from the model has been taken into account as lowering the spending limits (EUR 16.7 million). The NAOF's fiscal policy monitoring finds it good that the estimated employment impact of the model is not reflected in the spending limits. In order for public finances to benefit from the Nordic labour market service model as planned, it would be important to avoid taking the savings brought by the model to the spending limits to be allocated to new expenditure.

> The changes in the spending limits of 2022 and 2023 violate the principles of the spending limits system.

The increases in the spending limits of 2022 and 2023 have been made outside the spending limits calculation, as there is no justification for them under the spending limits rule or exceptions to the rule. The solution made in the mid-term review was justified by stating that, without the increases, the margin of manoeuvre provided by the spending limits would not make it possible to take into account unforeseen changes in expenditure and to implement all reforms that the Government considers necessary. The NAOF's fiscal policy monitoring considers that the decisions to raise the spending limits in 2022 and 2023 have clearly violated the principles of the spending limits system.

The spending limits system is needed as a tool for credible planning of expenditure

The main purpose of the spending limits system is to enable the level of central government expenditure during the government term to be credibly anticipated. The spending limits system makes it possible not only to set an expenditure target for the next four years but also to monitor whether the target is met. The spending limits system increases the Government's accountability for expenditure decisions, as it indicates whether the expenditure target set in the Government Programme has been complied with throughout the government term.

It is important to have reliable information on the use of central government expenditure in the coming years. Both public administration and external actors can utilize information on the expected use of central government expenditure in the coming years. Anticipating the level of expenditure also enables public administration to use expenditure cost-effectively.

The spending limits system does not prevent investments. It would be important to plan investments beyond government terms. The spending limits period is short when investments are made in, for example, combating climate change. A long-term plan forms a good knowledge base when decisions are taken in the Government Programme to bring investments within the scope of the spending limits. The aim of the national 12-year transport system plan, for example, has been to develop the transport system in a longer term and to assess the financing needs beyond government periods. A long-term plan also makes it easier to take the financing needs of its implementation into account in the General Government Fiscal Plan and in the spending limits set by the Government Programme.

> The spending limits system increases the Government's accountability for expenditure decisions, as it indicates whether the expenditure target set in the Government Programme has been complied with throughout the government term.

When developing the spending limits system, it would be important to avoid changes that enable the level of expenditure to be changed unexpectedly during the parliamentary term. Such changes would undermine anticipating the level of expenditure by means of the system, which has helped to maintain confidence and accountability in the use of central government expenditure since 2004.

Expenditure outside the spending limits increased during the Covid-19 pandemic

Since 2004, budget expenditure has been divided into spending limits expenditure and expenditure outside the spending limits. Expenditure outside the spending limits includes cyclical expenditure, such as unemployment security and social assistance (Figure 24). In addition, expenditure outside the spending limits also includes interest payments for central government debt, compensation to local government for tax cuts, and financial investments. Some of the expenditure items outside the spending limits are different types of pass-through items, which means that the budget has allocated revenue to offset the expenditure in question. Since 2021, expenditure directly related to the Covid-19 situation has also fallen outside the spending limits.

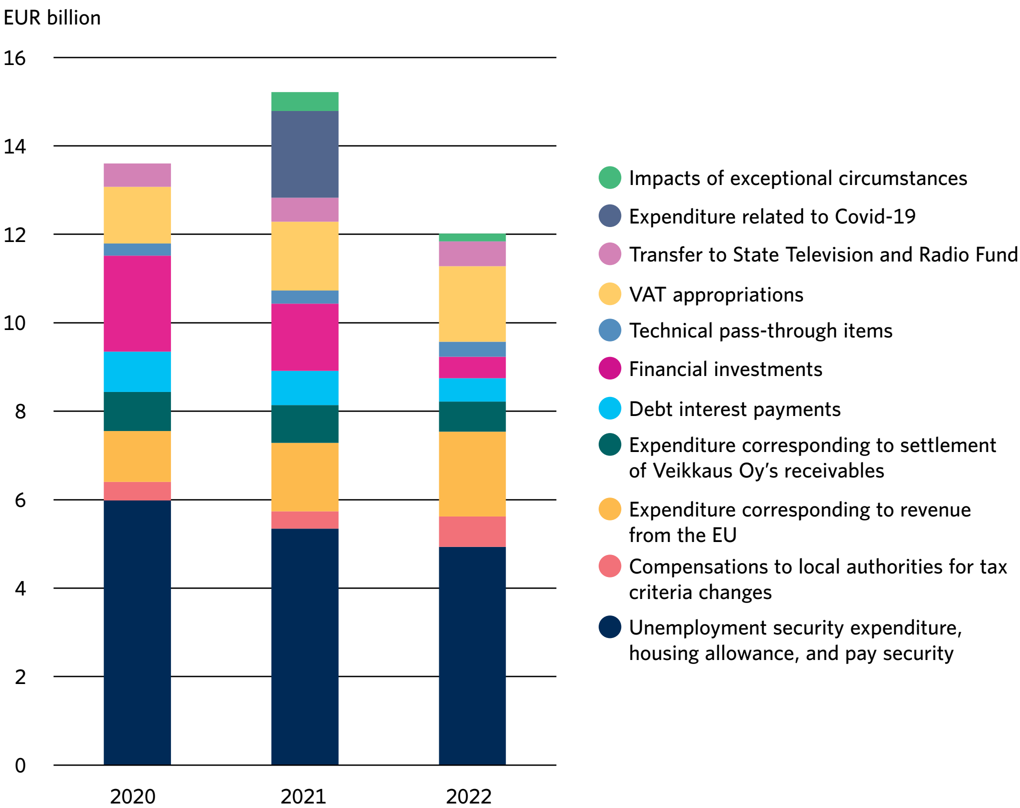

Figure 24: Expenditure outside the spending limits during the parliamentary term. Source: budget data, Ministry of Finance

Expenditure outside the spending limits has increased as a result of the Covid-19 pandemic. The solution to transfer expenditure related to health security in the Covid-19 situation outside the spending limits has worked well in the exceptional situation, and it has been possible to define direct costs quite clearly. The biggest increase in expenditure outside the spending limits can be seen in 2021, as in 2020 the spending limits were not in force, and in 2022 the amount of expenditure related to the management of the pandemic is expected to be small. Cyclical expenditure, which has increased as a result of the pandemic, is also expected to fall in 2022.

According to the spending limits principles, budget expenditure should fall within the scope of the spending limits. Exceptions to the principle can only be made for reasons justified by fiscal policy. In its report *Functioning of the central government spending limits system* 8/2021, the National Audit Office discussed expenditure outside spending limits. The National Audit Office is of the opinion that some of the expenditure currently outside the spending limits would be better suited as spending limits expenditure. Such expenditure includes the expenditure corresponding to the settlement of Veikkaus Oy's receivables and transfer to the State Television and Radio Fund. The report also proposed tightening the definition of financial investments and reassessing the cyclical nature of housing allowance.

Appendix: 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 well-being 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% to GDP) would not lead to the achievement of the objective set for structural fiscal position (−0.5 percentage points to GDP). However, as exceptional circumstances referred to in legislation are in force, the targets have been set in accordance with the decree.

Requirement set by the Decree	Estimate of compliance
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% in proportion to 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 is no longer sensible to monitor the expenditure limit in 2023". Nevertheless, the valid decree requires that the expenditure limit set for local government is monitored.
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 those 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 target path has been used in the stability programme. 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.

Requirement set by the Decree	Estimate of compliance
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.
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 it has 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.

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

2 Strifler, M. and Kokkinen, A., 2021a: A monthly business cycle heatmap for the Finnish Economy. Unpublished manuscript, Fiscal policy monitoring, NAOF.

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11 Strifler, M. and Kokkinen, A., 2021a.

12 Strifler, M. and Kokkinen, A., 2021c.

13 See Strifler, M. and Kokkinen, A., 2021b.

14 A description of the calculation of the impacts of employment measures on public finances can be found in the following reports: Fiscal policy monitoring report 2020, December 2020; Fiscal policy monitoring assessment on the management of general government finances, May 2020.

15 For more detailed information on the development and debt ratio target of the sustainability roadmap, see Fiscal policy monitoring report 2020, December 2020, and Fiscal policy monitoring assessment on the management of central government finances, May 2020.

16 See Sustainability assessments of general government finances in the knowledge base of economic policy; audit report of the National Audit Office 16/2019.

17 The economic forecast of the Ministry of Finance is compared with the forecasts of the following actors: Akava Works, 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), 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.

18 The forecast of the Ministry of Finance was published on 27 September 2021. The forecasts of the other forecasters of the Finnish economy were published between 9 June and 11 November 2021.

19 Ministry of Finance, Economic Survey, Autumn 2021, page 37.

20 RECOMMENDATION OF THE EUROPEAN CENTRAL BANK of 15 December 2020 on dividend distributions during the COVID-19 pandemic and repealing Recommendation ECB/2020/35 (ECB/2020/62)

21 Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact, 20 March 2020, COM(2020) 123 final.

22 Communication from the Commission: Annual Sustainable Growth Strategy 2021, 17 September 2020, COM(2020) 575 final.

23 Communication from the Commission: Economic policy coordination in 2021: overcoming COVID-19, supporting the recovery and modernising our economy, 2 June 2021, COM(2021) 500 final.

24 Communication from the Commission: One year since the outbreak of COVID-19: fiscal policy response, 3 March 2021, COM(2021) 105 final.

25 Council Recommendation of 18 June 2021 delivering a Council opinion on the 2021 Stability Programme of Finland.

26 Communication from the Commission: The EU economy after COVID-19: implications for economic governance, 19 October 2021, COM(2021) 662 final.

27 The European Fiscal Board was established on the basis of "The Five Presidents' Report: Completing Europe's Economic and Monetary Union". The aim is to strengthen economic governance. The main tasks of the Board include assessing the implementation of the EU fiscal framework and the appropriateness of the actual fiscal stance in the euro area, and making proposals at national level for the future development of the EU fiscal framework.

28 See Strifler, M. and Kokkinen, A., 2021a.

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30 Bénassy-Quéré, A., M. Brunnermeier, H. Enderlein, E. Farhi, M. Fratzscher, C. Fuest, P. Gourinchas et al. (2018), "Reconciling Risk Sharing with Market Discipline: A Constructive Approach to Euro Area Reform." CEPR Policy Insight 91.; European Fiscal Board (2020), Annual Report 2020, Brussels.; Darvas, Z. & Anderson, J. (2020) "New life for an old framework: redesigning the European Union's expenditure and golden fiscal rules", European Parliament.; Martin, P, J Pisani-Ferry & X Ragot (2021), "Reforming the European Fiscal Framework", Les notes du conseil d'analyse économique, no 63.

31 Blanchard O.J., Á. Leandro & J. Zettelmeyer (2021), "21-1 Redesigning EU Fiscal Rules: From Rules to Standards", PIIE Working Paper, no 21/1

32 e.g. Claeys, G., S. Tagliapietra & G. Zachmann (2019) "How to make the European Green Deal work", Policy Contribution 2019/13, Bruegel; European Fiscal Board (2020), Annual Report 2020, Brussels.

33 Additional investments could be defined, for example, as investments that exceed the calculated average investments per Member State for a given period.

34 This depends on how much room for manoeuvre there is between the expenditure ceiling based on the rule and public expenditure (i.e. in some cases, additional investments can be made within the expenditure ceiling) and how quickly additional investments begin to impact economic growth.

35 Publication of the Secretariat and a working group of the network of EU IFIs: 23 November 2021.

36 In their blog post, A. Kokkinen and M. Strifler reflect on different net debt indicators and whether the inclusion of financial assets could encourage Member States to build buffers during an economic upturn. See Kokkinen A. and Strifler M. (2021), "Reflecting on EU fiscal rules – is there any alternative to the debt rule?", NAOF blog post, 30 September 2021.

37 see, for example, Martin, P, J Pisani-Ferry & X Ragot (2021), "Reforming the European Fiscal Framework", Les notes du conseil d'analyse économique, no 63.

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39 Act on the implementation of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, the implementation of Treaty provisions of a legislative nature as well as requirements concerning multi-annual budgetary frameworks (869/2012).

40 Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, concluded on 2 March 2012.

41 Economic policy coordination in 2021: overcoming COVID-19, supporting the recovery and modernising our economy. Communication from the Commission, COM(2021) 500.

42 Communication from the Commission on 19 October 2021, COM (2021) 662: The EU economy after COVID-19: implications for economic governance

43 The purpose of the provisions referred to here can be derived, for example, from the Commission's communication on common principles related to national fiscal correction mechanisms (COM/2012/0342 final).

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