Fiscal policy monitoring assessment on the management of general government finances

D/426/04.04.01/2024

This memorandum includes the spring 2024 assessment of the fiscal policy monitoring function of the National Audit Office of Finland (NAOF) on the development and management of general government finances. It is a statutory task of the National Audit Office to monitor that central government finances are managed in compliance with the Fiscal Policy Act (869/2012) and the Decree on the General Government Fiscal Plan (120/2014), issued thereunder. The General Government Fiscal Plan for 2025–2028 and the Government proposals on employment measures have been taken into account in the assessment. The assessment is based on the calculations by the fiscal policy monitoring function, the independent economic forecast issued by the Ministry of Finance in April 2024, other economic forecasts, and the background memoranda published by the Ministry of Finance.

The previous assessment of the fiscal policy monitoring function was presented in the fiscal policy monitoring report published on 15 December 2023[1]. The December report presented key findings on the factors underlying the increase in Finland's general government debt, the Government's objectives and measures, and the reform of the EU’s fiscal rules. The fiscal policy monitoring function will publish a more extensive fiscal policy report again in December 2024.

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[1]The NAOF's separate report to Parliament: Fiscal policy monitoring report, R 21/2023 vp.

Contents

Summary

The development of the Finnish economy in the winter was weak. However, after a long period of weakening, which started in the summer of 2022, it seems that the rock bottom has been reached and an upturn is about to start. According to the forecast of the business cycle heatmap, the recovery of the economy in 2024–2025 will be slow and fragile. After the financial crisis, Finland's general government expenditure has increased faster than revenue, which has resulted in a general government deficit of permanent nature. The underlying factors are mainly structural, i.e. non-cyclical, such as the ageing of the population. Another factor observed is the increasing purchasing costs of local government administrative services, which would require a more detailed analysis. The economic forecast of the Ministry of Finance is mainly in line with those of other forecasters but differs from them in 2025 as regards the investment forecast, for example.

In its Government Programme, the current Government set itself the objective of improving the general government fiscal position and putting the government debt on a downward path. The objectives are justified from the perspective of long-term debt sustainability in Finland. In spring 2024, the Government specified its fiscal objectives and decided on additional adjustment measures of EUR 3 billion. However, in the light of the current forecasts, the Government's objectives for the fiscal position and debt will not be achieved despite further measures. Nevertheless, it should be noted that the parliamentary term is still in its early stages. Despite the adjustment measures now decided, the government debt ratio in Finland is forecast to grow in the long term. The question is whether measures should be directed to a greater extent at the causes of spending needs (e.g. ageing) in order to better control the long-term growth of Finland's general government debt-to-GDP ratio.

After the spring 2024 Government discussion on spending limits, the spending limits were tightened. The Government's savings target of EUR 1.5 billion will be reached according to the calculations made at this stage of the parliamentary term, but some additional expenditure of the investment programme has not yet been included in the spending limits. The level of fiscal policy in forecast years 2024–2025 is counter-cyclical, i.e. slightly expansionary in a negative business cycle. The fiscal impulse, i.e. the change in fiscal policy, will be counter-cyclically contractionary in 2025. The Government's fiscal policy is therefore in line with the short-term business cycle. The Government is committed to achieving 100,000 new employed people, and thereby EUR 2 billion savings, by structural measures through the (dynamic) impacts of the new employed people by 2027. It is good that the employment measures have been linked with a fiscal target in euros. The employment measures have progressed rapidly. In addition to the dynamic impact, it is important to consider the total impact of the measures on public finances. According to calculations by the fiscal policy monitoring function, the total employment impact of the measures decided so far is 72,800 new employed people (lower and upper bounds 65,200 and 82,100, respectively). According to an ex-ante estimate, the dynamic impact of the measures on public finances totals approximately EUR 1.7 billion. The related lower and upper bounds are EUR 1.3 billion and EUR 2.1 billion, respectively. According to an ex-ante estimate, the total impact on public finances is around EUR 2.5 billion, and the related lower and upper bounds are EUR 2.0 billion and EUR 2.9 billion, respectively. It seems that some of the impacts of the measures will only be seen in years following the parliamentary period.

The reform of the EU fiscal framework entered into force on 30 April 2024. Compliance with the new rules will no longer be monitored on the basis of the development of the general government structural balance in relation to GDP. In addition, if the debt-to-GDP ratio exceeds 60%, the development of the ratio is no longer monitored directly when compliance with the debt criterion is assessed. These methods are replaced by monitoring a net expenditure path specific for each Member State. The net expenditure path is based on debt sustainability analysis. The net expenditure path referred to in the new legislation has not yet been defined. Therefore, the prospects for compliance with it are not assessed in this report. The net expenditure path applied to Finland will be defined in autumn 2024. The general government deficit is subject to the 3% reference value, which continues to be in force after the reform of the rules. Finland risks breaching this reference value.

1 The business cycle and the state of general government finances

1.1 The business cycle is weak – slow recovery ahead

The business cycle continued to be cool and weak over the winter. In April 2024, the colour code of the business cycle heat map produced by the fiscal policy monitoring function turned dark blue, which illustrates a weak business cycle (Figure 1).[2] The main factors underlying this were high price levels, high interest rates, the consequences of Russia's war of aggression, and the geopolitical tensions and related uncertainty about the world economy and international division of labour.

Year	Vacancies, change	Capacity utilisation	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)
2024												
4	-1,89	-0,75	-0,08	-1,67		-1,03	-1,42	-1,12	-1,16	-0,48	-1,24	-0,93
3	-1,81	-0,92	0,06	-1,21	-1,28	-1,06	-1,66	-0,85	-1,57	-0,55	-0,39	-1,01
2	-1,35	-0,95	0,44	-1,13	0,18	-1,02	-1,82	-0,72	-0,96	-0,46	-0,62	-0,68
1	-1,16	-1,00	0,59	-1,07	0,05	-0,65	-1,67	-0,90	-0,55	-0,53	-0,34	-0,61
2023												
12	-1,60	-1,41	0,73	-1,63	-0,75	-0,85	-1,58	-1,33	-0,82	-0,62	-0,92	-0,94
11	-1,72	-1,06	0,59	-1,59	-0,28	-1,09	-1,88	-1,41	-1,22	-0,56	-0,42	-0,96
10	-2,08	-1,17	1,35	-1,65	0,08	-1,21	-1,81	-1,35	-1,35	-0,45	-0,49	-0,90
9	-1,92	-0,97	1,63	-1,53	0,18	-1,09	-1,56	-1,47	-0,27	-0,24	-0,78	-0,69
8	-1,88	-1,00	1,68	-0,82	0,15	-0,68	-1,28	-1,26	0,06	-0,04	-0,43	-0,49
7	-1,88	-0,95	2,11	-0,96	0,12	-0,77	-1,30	-1,29	-1,32	-0,14	-1,04	-0,63
6	-2,00	-0,76	2,01	-0,92	1,78	-0,71	-0,87	-1,08	-0,27	0,02	-0,28	-0,28
5	-1,80	-0,53	2,25	-1,01	1,05	-0,59	0,04	-0,78	-0,01	0,15	-0,16	-0,17
4	-1,60	-0,44	2,77	-0,84	0,72	-0,48	-0,95	-0,84	0,07	0,02	-0,01	-0,13
3	-1,36	-0,46	2,77	-1,44	0,62	-0,31	-0,42	-0,81	0,14	0,09	-0,13	-0,11
2	-1,11	-0,09	3,20	-1,55	0,28	-0,49	-0,64	-0,47	-0,07	0,26	-1,14	-0,05
1	-0,85	-0,36	3,01	-1,73	0,58	-0,76	-0,79	-0,18	0,07	0,44	-1,41	-0,01

Figure 1: Heatmap produced by the fiscal policy monitoring function (16 May 2024). Source: Statistics Finland, Ministry of Economic Affairs and Employment, European Commission, Confederation of Finnish Industries, and calculations by the fiscal policy monitoring function.[3]

Inflation (change in the consumer price index, column 3) has been slowing down significantly since the exceptional years 2022–2023, and its colour code has gradually changed to be again in line with the other heatmap variables.[4] However, the rapidly rising price level and high interest rates continue to have a negative impact on consumer confidence, particularly on construction confidence. The high interest rates are slowing down the whole economy, which is reflected in the rather dark blue colour coding of the economic confidence indicators. The weak business cycle was also broadly visible in the labour market in spring 2024. The fall in vacancies began already at the end of 2022, whereas the weak trend in unemployment and employment did not begin until in autumn 2023. Currently, vacancies, unemployment and employment appear in the heatmap with dark and light blue colour coding.

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[2] The business cycle heatmap is a tool that describes the business cycle in Finland by means of colour codes and is based on indicators illustrating the state of the Finnish economy. The higher the share of red indicators at the same time, the more likely it is that the economy is experiencing good times, and the higher the share of blue, the more likely it is that the economy is experiencing bad times. Further information on the business cycle heatmap is available on the web page of the heatmap, the fiscal policy monitoring report of December (2021b), and the fiscal policy monitoring assessment of June (2021a), (Strifler, M. & Kokkinen, A., 2021a).

[3] Strifler and Kokkinen(2021a).

[4] The different development of consumer prices compared with the other heatmap indicators has been explained, for example, in the fiscal policy monitoring report (2023).

The monthly composite indicator has fallen rapidly from its peak in early 2022 (Figure 2). Since December 2022, the figure has been below zero, which means that the economic outlook has been negative ever since. The composite indicator continued to fall rapidly throughout 2023. The back-and-forth changes in the first months of 2024 may signal that the rock bottom has been reached. The economic outlook in spring 2024 is uncertain and weak, but the slowdown of inflation and the slow improvement in purchasing power give hope that the development will take a turn for the better.

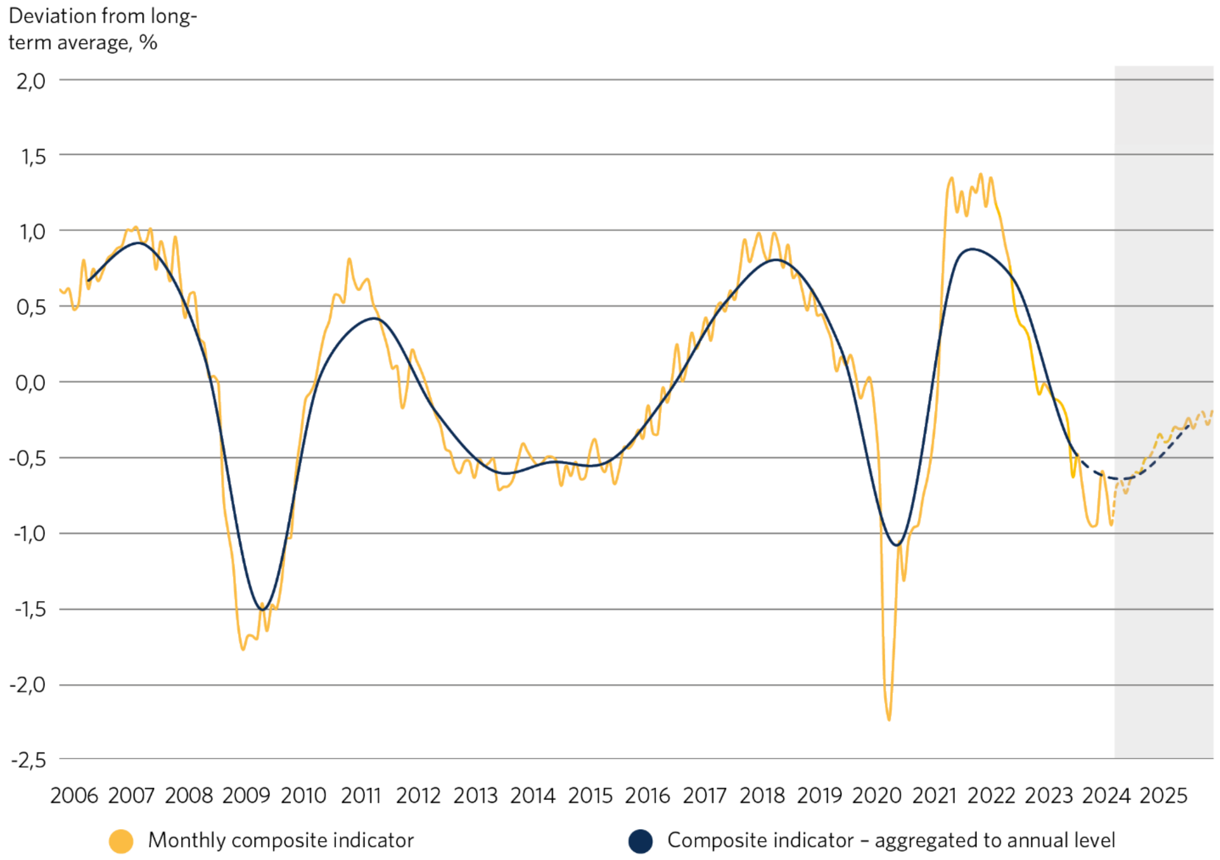

Figure 2: Monthly (yellow line) and annual (blue line) composite indicator and forecast for the next year (grey background). The forecast is based on the heatmap data and other statistics available by 3 May 2024. Source: Statistics Finland, Ministry of Economic Affairs and Employment, Confederation of Finnish Industries, European Commission. Calculations and forecasts: fiscal policy monitoring function.[5]

According to the current and next year's forecast of the composite indicator of the heatmap of the fiscal policy monitoring function, the economy will continue to adapt to the adverse impacts of the uncertainty caused by the high price levels and interest rates, war, economic sanctions, energy crisis, growth of trade barriers, and geopolitical tensions. Therefore, the business cycle will develop slowly in the near future (see Figure 2). As we predicted in autumn 2023, the spring 2024 forecast of the heatmap indicates that the rock bottom has been reached by spring/summer 2024. After that, the business cycle is expected to recover, but the recovery will be slow and fragile. The slow improvement of purchasing power is the main driver of the sluggish recovery, but the rather weak development of real wages may in the long run improve Finland's relative competitiveness. The composite indicator seems to be below zero, i.e. the long-term average, until the end of 2025. The forecast continues to support the view that a soft landing and recovery without a sharp economic collapse are possible. However, the risks of worse development are high. The forecast of the composite indicator of the heatmap is quite similar to the Ministry of Finance's forecast of the difference, or gap, between observed GDP and estimated long-term potential GDP (see Appendix 1).

[5] Strifler and Kokkinen(2021b).

1.2 General government expenditure has increased sharply after the financial crisis – the underlying factors are structural

After the financial crisis, the primary balance of the debt-accumulating sectors of the Finnish general government (central government, local government, and social security funds other than earnings-related pension funds) has been the biggest factor increasing Finland's government debt-to-GDP ratio (NAOF, fiscal policy monitoring function, 2023). Primary balance refers to the difference between revenue and expenditure, net of interest payments. In order to provide a better understanding of the factors affecting the negative primary balance, this memorandum examines general government revenue and expenditure in greater detail.[6] Earnings-related pension funds are itemised because their surplus does not reduce general government debt but is used for net acquisition of financial assets[7].

Over the entire review period (2001–2023), the level of the revenue-to-GDP ratio of the government debt-accumulating sectors has remained relatively high compared with other countries,[8] i.e. at around 40%–42%. At the same time, the expenditure-to-GDP ratio has increased since the financial crisis, varying between 42% and 46%, which means that it has remained at a higher level than revenue. Since the financial crisis (2008), the expenditure (excluding interest payments) of the government debt-accumulating sectors has exceeded the revenue by an average of 2.3 percentage points (Figure 3, left). This means that the revenue would not have covered the expenditure even in the absence of interest payments. The primary balance was negative even when the economy was growing in 2017–2019, which means that the imbalance between revenue and expenditure was not rectified even in a favourable business cycle.

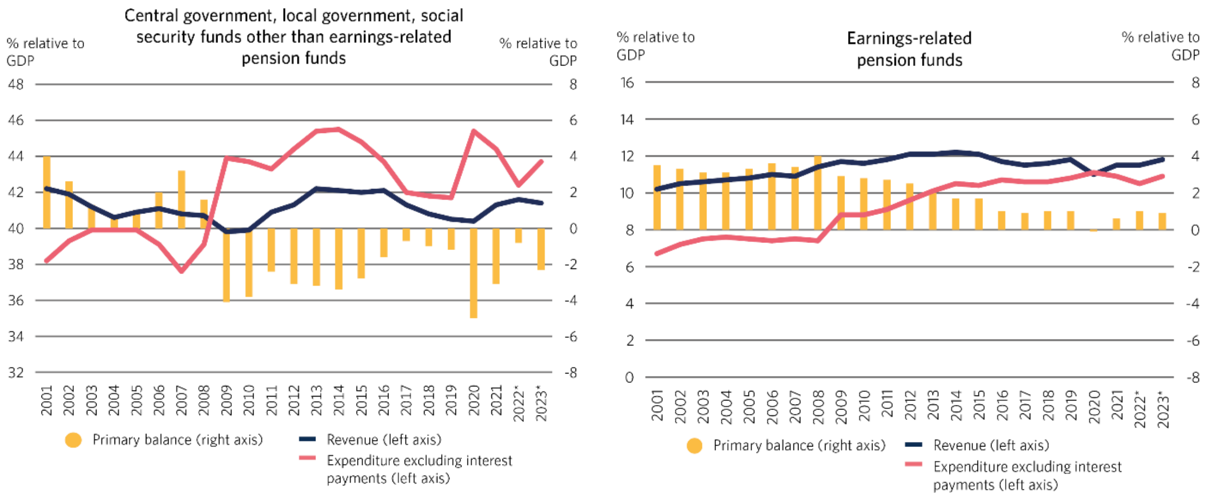

Figure 3: General government revenue and expenditure (excluding interest payments) and primary balance. The general government, excluding earnings-related pension funds, i.e. the central government, local government, and social security funds other than earnings-related pension funds, are shown on the left. The earnings-related pension funds are shown on the right. Source: Statistics Finland (2024a) and calculations by the fiscal policy monitoring function.

Earnings-related pension funds have reported surplus almost continuously since the financial crisis, but their primary surplus has decreased by an average of 0.2 percentage points a year (Figure 3, right). This is because pension expenditure has increased faster than the revenue of the earnings-related pension funds.

In addition to the ratios of total revenue and expenditure to GDP, it is useful to examine how the revenue and expenditure sub-items have developed. After the financial crisis, the revenue-to-GDP ratio of the general government's debt-accumulating sectors (central government, local government, social security funds other than earnings-related pension funds) increased by 0.7 percentage points between 2008 and 2023. The reason for this was an increase in the

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[6] In order for general government revenue and expenditure to be added up to get the primary balance, we examine these items as consolidated.

[7] The net acquisition of earnings-related pension funds' financial assets is reflected in the stock-flow adjustment (NAOF, fiscal policy monitoring function, 2023).

[8] The revenue-to-GDP ratio of Finland's general government as a whole is the fourth highest in the OECD countries (OECD, 2024a). The expenditure-to-GDP ratio is also the fourth highest in the OECD countries (OECD, 2024c).

revenue from the sales of goods and services (1.0 percentage point), in tax revenue (0.2 percentage point), and in capital income (0.1 percentage point). The GDP ratio of other revenue items has remained stable or slightly decreased (Figure 4, left).

The expenditure-to-GDP ratio of the debt-accumulating sectors, in turn, has increased by 4.6 percentage points (Figure 4, right). The main factors that explain the increase in expenditure are the growth in the purchasing costs of goods and services (intermediate consumption) (3.0 percentage points) and the growth in transfers in kind (1.2 percentage points), of which a total of roughly 1.5 percentage points is explained by ageing. [9] The remainder, 2.7 percentage points, is explained by other reasons. The most important "other reason" is the costs of purchasing local government goods and services, such as services to support the administration[10] (1.2 percentage points).

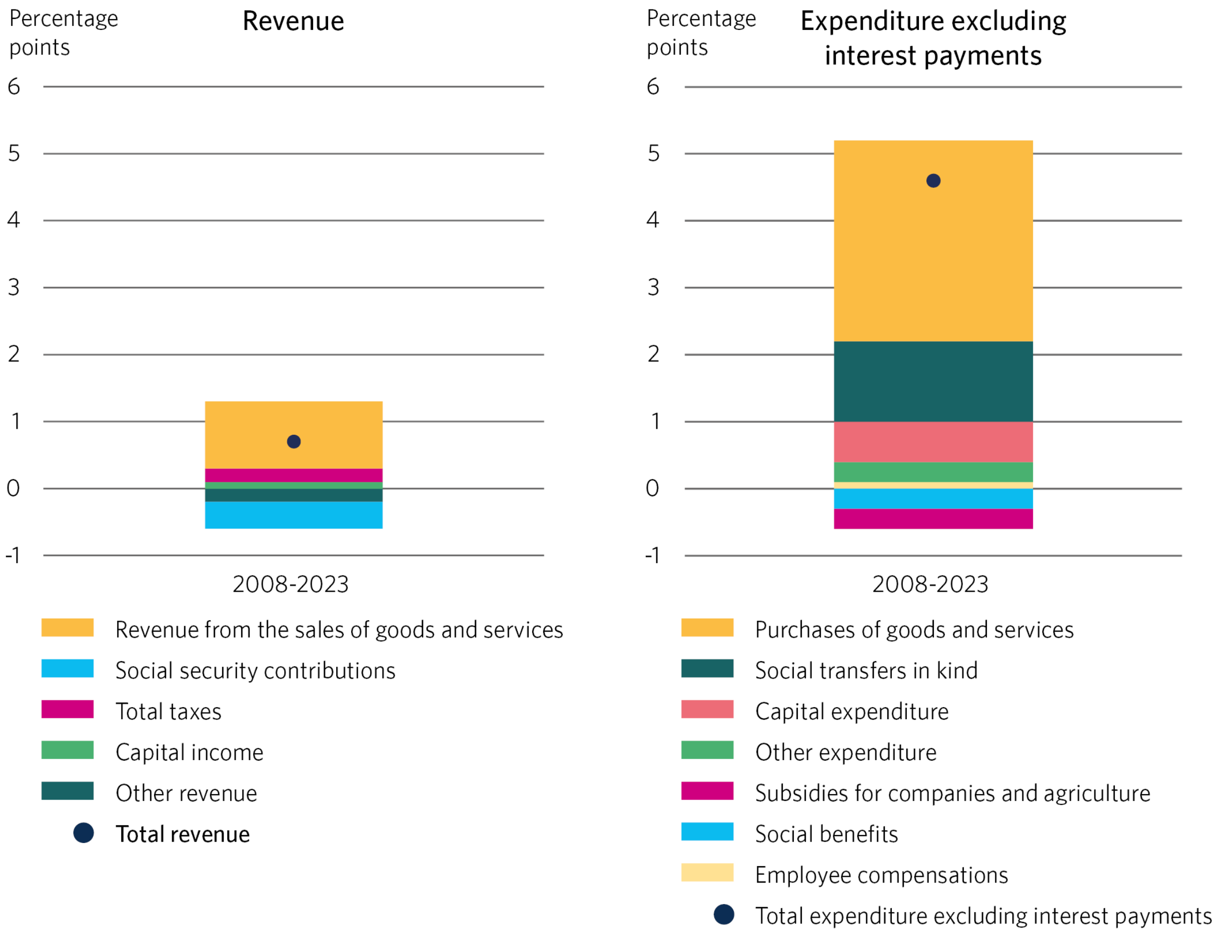

Figure 4: Factors contributing to the growth of the revenue and expenditure of the general government's debt-accumulating sectors (central government, local government, social security funds other than earnings-related pension funds). Change from 2008 to 2023 in percentage points. Source: Statistics Finland (2024a) and calculations by the fiscal policy monitoring function.

[9] At the time of writing this report, "General government expenditure by function" (Tilastokeskus, 2024b) is available only until 2022. The categories hospital services, outpatient services, and old age according to the COFOG classification have been considered ageing-related expenditure.

[10] The purchasing costs of local government goods and services (intermediate consumption) has increased since the financial crisis, especially in category "G0103 General services". The underlying factors seem to be mainly the incorporation of services provided by municipalities and joint municipal authorities and possibly the purchase of services by municipalities from private actors. Given the magnitude of the growth of the item, this should be examined in greater detail. Statistics Finland (2024c) has reported that the accounting data will be specified in autumn 2024, and in the case of general government bodies, items arising from internal trade within the general government will be removed. This may affect the expenditure item in question and possibly also revenue.

Since the financial crisis, the revenue-to-GDP ratio of earnings-related pension funds has increased slightly (by 0.4 percentage points), which is due to an increase in social security contributions (Figure 5, left). The expenditure-to-GDP ratio (excluding interest payments) of earnings-related pension funds, in turn, has increased strongly (by 3.6 percentage points) (Figure 5, right). This is mainly due to an increase in pension expenditure related to ageing of the population.

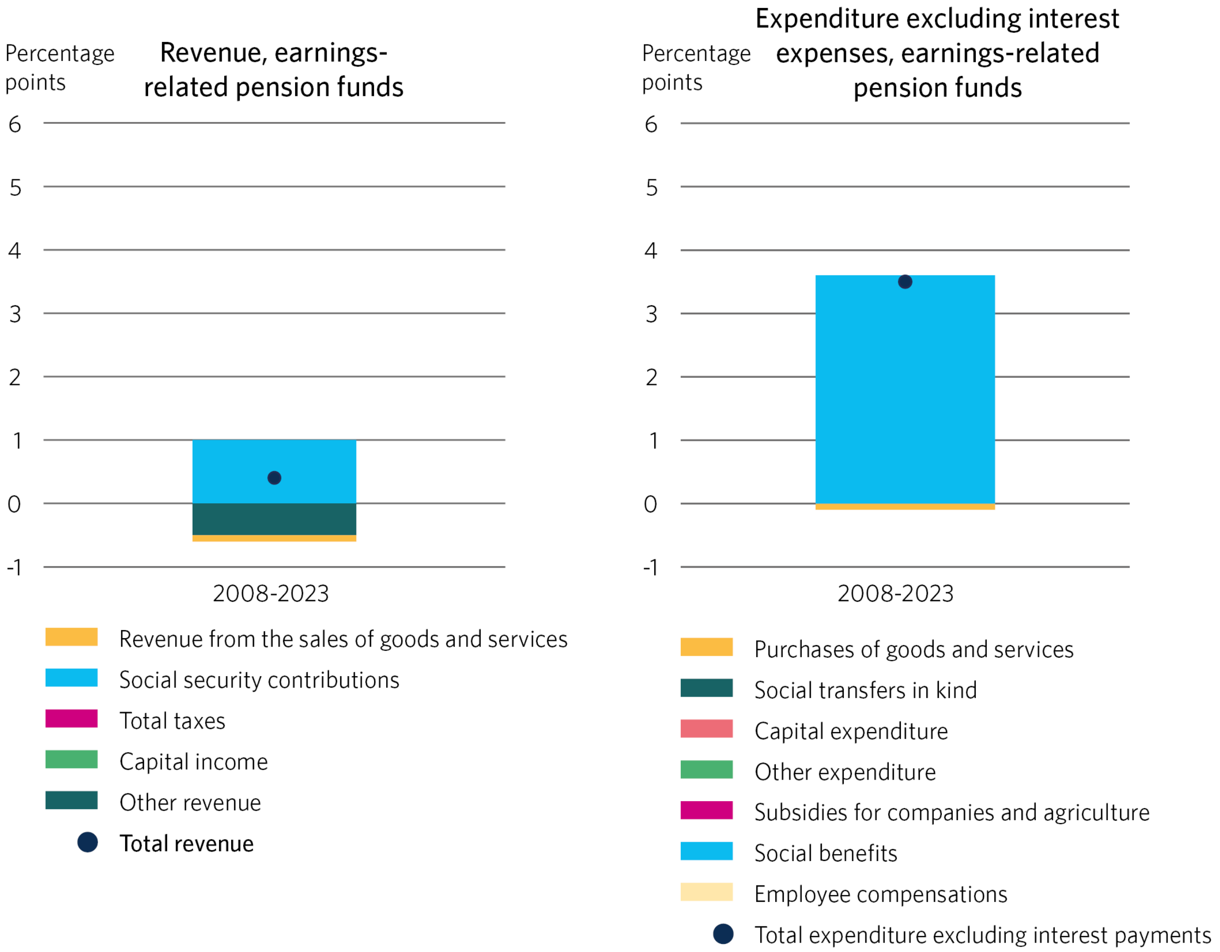

Figure 5: Factors affecting the increase in revenue and expenditure of earnings-related pension funds. Change from 2008 to 2023 in percentage points. Source: Statistics Finland (2024a) and calculations by the fiscal policy monitoring function.

Based on this, it can be concluded that structural factors (ageing and the factor increasing the purchasing costs of administrative services in the local government) explain most (75%) of the growth of the general government total expenditure. When measures are taken to curb the increase in debt, it is important to have a better understanding of the factors behind the increase in general government expenditure.

1.3 The economic growth forecasts of the Ministry of Finance are in line with those of other forecasters – partial differences in investments and public consumption in 2025

As part of the assessment of the realism of forecasts, the Ministry of Finance's (MoF) forecast is compared, by means of a sample of forecasts compiled of other forecasts, with the 95% prediction intervals[11] formed for the population of the actors forecasting the Finnish economy and with the consensus forecast[12]. Differences alone do not indicate the realism of the Ministry of Finance's forecast, but the comparison makes it possible to examine the forecasters' overall picture of the economic development. The forecasts included in the comparison were prepared between 12 December 2023 and 25 April 2024. It should also be noted that the forecasts for the sub-items of the consensus forecast are not necessarily in line with each other, as they are calculated as an average, while taking into account the dates of the forecasts. In addition, it has been possible for the Ministry of Finance's forecast to take into account the adjustment measures agreed on, based on an ex-ante estimate, in the Government discussion on spending limits.

Based on the sample of forecasts compiled by the fiscal policy monitoring function, the recession in Finland has been deeper than expected, and the latest fiscal forecasts have been revised and become slightly more pessimistic. In the global geopolitical situation and the development of interest rates in the euro area, there are still negative risk factors that, if realised, will significantly weaken the economic development in Finland.

According to the sample of forecasts compiled, the economic development of the current year is weak. The growth of GDP is expected to remain at about zero or below, and of the demand items in the national economy, only private consumption is forecast to grow. In its forecasts for 2024, the Ministry of Finance presents a very similar picture of the economic development in Finland as the other forecasters. The biggest difference is in the Ministry of Finance's forecast for investments, which is 1.4 percentage points higher than the consensus forecast. However, it should be noted that the forecasts for investments, imports, and exports are uncertain, which is reflected in high standard deviation and wide prediction intervals (Appendix 2).

As regards the fiscal forecast for 2024, the general government deficit in relation to GDP is projected to remain above the 3% level, and the general government debt ratio is projected to continue to grow rapidly. Despite taking the adjustment measures into account, the Ministry of Finance's government debt forecast has been revised upwards, and it is now one of the highest in the forecast population. The Ministry of Finance forecasts the debt ratio to grow to 80.9% in 2024 and to 82.8% in 2025.

In 2025, the economic development is expected to be slightly more positive (Figure 6). Finland's GDP is expected to start to grow, and the general government deficit is expected to fall slightly below 3% relative to GDP. The Ministry of Finance estimates that the adjustment measures will reduce GDP growth cumulatively by around 0.5% in 2025 and 2026. The impact is mainly due to the negative short-term impact of the measures on private and public consumption. The cumulative effect of tighter fiscal policy on economic growth depends on many factors, and it is difficult to give an unambiguous estimate of it. However, it is possible that the agreed adjustment measures will lead to weaker economic growth than projected in 2025 and 2026 (see also chapter 2.3).

However, the Ministry of Finance's real economy forecast for 2025 differs from those of the other forecasters in both investments and public consumption. The Ministry's forecasts for both of these are outside the 95% prediction intervals which take the date of the forecast into account. As regards public consumption, the Ministry of Finance is the only actor forecasting that it will become negative, -0.9%, in 2025, which is a 1.5 percentage points more negative forecast than the consensus forecast. As regards investments, the forecast of the Ministry of Finance (5.4%) is 1.8 percentage points higher.

[11] The prediction intervals have been formed by means of forecasts of 17 actors other than the Ministry of Finance, and they describe the bounds within which 95 per cent of the forecasts are estimated to fall. These forecasters are Akava Works, Aktia, Danske Bank, the Finnish Centre for Pensions, ETLA Economic Research, the European Commission, Handelsbanken, the Mortgage Society of Finland (Hypo), the International Monetary Fund (IMF), MuniFin, Labore, Nordea, OP, POP Bank, Pellervo Economic Research (PTT), the Bank of Finland, and Savings Bank. All of these forecasters do not produce forecasts in the same scope as the Ministry of Finance.

[12] The consensus forecast is based on the mean of the other forecasts, and it also takes into account the time when the forecast was prepared. The later the forecast has been prepared, the more information on the business cycle and data updates it has been possible to take into account in its preparation. The forecasts issued closer to the end of the period are thus likely to be more accurate than those issued at the beginning of the period. This is reflected in the trend of the consensus forecast.

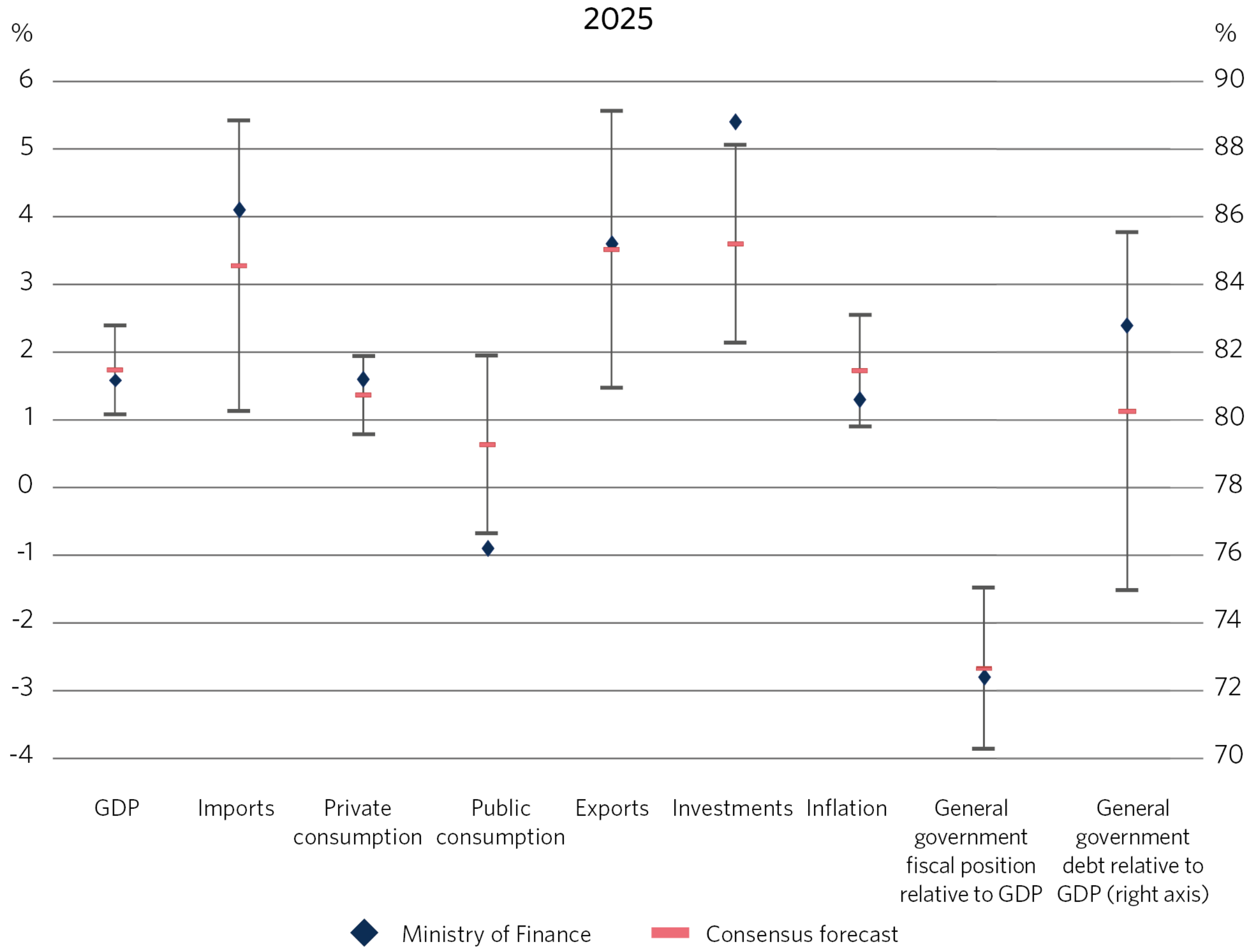

Figure 6: The Ministry of Finance's forecasts, the values of corresponding consensus forecasts on the publication date of the Ministry of Finance's forecast, and the 95% prediction intervals for 2025. Forecasts for supply and demand items are expressed as changes in volume, other forecasts as a percentage. Source: forecasters and the fiscal policy monitoring function.

The Ministry of Finance's investment forecast for 2025 is higher than in the winter 2023 forecast, which is due to the increase in the forecast private investments. The Ministry expects lower interest rates, digitalisation, and green investments to accelerate private investments more than previously estimated. The forecasts for other residential construction and machinery and equipment, in particular, are now two percentage points higher than before. The Ministry's overall estimate of the development of investments differs from that of the other forecasters. However, it should be noted that forecasting investments is uncertain in nature and that several factors have an impact on their actual development. The current uncertainty is also reflected in the size of the prediction intervals.

The Ministry's forecasts for public consumption are affected significantly by the savings measures on which the Government agreed in the spring. These measures reduce public consumption expenditure and explain the differences between the forecasts. The other forecasters have not been able to take into account the latest savings measures in their forecast, and therefore both the consensus forecast and the prediction intervals are at a higher level. Compared with its winter forecast, the Ministry of Finance has revised its public consumption forecast clearly downwards to reflect the latest decisions and give a more up-to-date picture of the development of public consumption.

2 Assessment of the Government's fiscal policy

2.1 The Government has taken further adjustment measures to achieve its objectives

In its Government Programme, the current Government set itself the objective of improving the general government fiscal position[13] and putting government debt on a downward path (Finnish Government, 2023). In autumn 2023, the Government decided to take the adjustment measures according to the Government Programme, but according to expert estimates, additional measures were needed to achieve the targets (see e.g. National Audit Office, 2023). After autumn 2023, economic growth forecasts, for example, have weakened[14], which has further weakened the forecasts for the general government fiscal position and the debt-to-GDP ratio.

The Government has specified its fiscal policy targets in the spring 2024 General Government Fiscal Plan (Ministry of Finance, 2024b). The targets for spring 2024 are similar to the previous ones, but as a result of the weakening of the economic situation, the fiscal position target set for the end of the parliamentary term has changed from the -1.0% in relation to GDP presented in the Government Programme to -1.3% in relation to GDP. Despite this, the target is still close to the previous one. If the target is reached, the situation will be considerably better than the current situation and forecasts. Taking into account the business cycle, the nominal balance target would not lead to the achievement of the structural balance target in 2027 and 2028 (see Appendix 2).

Following the weakening of economic growth forecasts and statistics, the target set for the debt-to-GDP ratio in 2027 has been changed from 77.3% to 81.9%, but the Government is still striving to stabilise the debt-to-GDP ratio. Improving the ratio of debt and fiscal position to GDP are still justified targets for the Government from the perspective of long-term sustainability of Finland's general government finances. The Government should assess the need for further measures regularly during the parliamentary term.

The additional measures decided by the Government in spring 2024 amount to a total of approximately EUR 3 billion, consisting of both revenue and expenditure measures targeted at on-budget activities. According to the latest forecast of the Ministry of Finance, the additional measures will improve the fiscal position of the central government.

The revenue measures consist mainly of tax increases. The most significant tax increases are made in value added taxation[15] and taxation on earned income.[16] The tax increases aim to generate around EUR 1.7 billion of additional revenue at the level of 2027 (Figure 7, left). However, the dynamic impacts of all revenue measures have not been estimated[17]. Therefore, it is possible that tax revenue will not be realised in accordance with the targets due to the adverse impacts of tax increases on economic growth. The Ministry of Finance estimates that of the EUR 1.8 billion target for 2028, only EUR 1.5 billion would probably be realised if dynamic impacts were taken into account (Ministry of Finance, 2024b, p. 21). At the same time, the revenue from several tax types is forecast to decrease for other reasons, such as the weak economic growth, by approximately EUR 1.5 billion at the 2027 level (Figure 7, left). On the one hand, the inclusion of revenue measures is justified when consolidation needs are significant (National Audit Office, 2023). On the other hand, the tax increases decided may have negative impacts on incentives to work and invest, which may further slow down the economic growth in Finland[18]. Therefore, the tax revenue may ultimately be lower than estimated.

Expenditure measures aim to curb the increase in expenditure. Without further measures taken by the Government, the expenditure of on-budget activities will increase by EUR 0.7 billion at the level of 2027, due to, for example, index

[13]General government fiscal position refers to the difference between general government revenue and expenditure. When revenue exceeds expenditure, the fiscal position is positive, which means that general government bodies report surplus. When revenue is lower than expenditure, the fiscal position is negative, which means that general government bodies report deficit.

[14]In autumn 2023, the Ministry of Finance forecast economic growth of 1.2% for 2024 and 1.8% for 2025, whereas in the spring 2024 forecast, the corresponding figures were 0.0% and 1.6%. The actual economic growth figures in statistics have also been revised downwards since last autumn.

[15]Finland's general VAT rate will rise to 25.5% and be the second highest in the EU (Euroopan Unioni, 2024), and the VAT rate on sweets will be raised from 14% to 25.5%.

[16]The taxation of earned income will increase with pensioners, high-income earners, and those saving voluntarily for retirement. The tax credit for household expenses will decrease.

[17]The list of measures published (in Finnish) by the Ministry of Finance shows the measures whose dynamic impacts have not been estimated, as it can be very difficult to estimate dynamic impacts. These include, for example, increases in taxation of earned income, reduction in the tax credit for household expenses, and increases in taxation of alcohol.

[18]The adverse effects of tighter taxation of earned income, for example, on economic growth are widely known in literature (see e.g. Nguyen ym., 2021). In the long term, economic growth is based on the accumulation of capital (fixed or human) and on the resulting improved productivity (see Mäki-Fränti ym., 2023). A fiscal policy that supports these issues also supports economic growth.

adjustments, such as automatic price and cost level adjustments, changes in estimated needs, the implementation of various projects, an increase in the number of refugees, and an increase in guarantee liability expenditure (Figure 7, right). As a result of the new decisions, expenditure will be reduced by almost EUR 1.5 billion at the level of the end of the parliamentary term (2027) (Figure 7, right). The additional savings decided by the Government are mainly targeted at social security, health care, and public administration (Figure 8, right). The most significant individual revenue and expenditure measures amount to more than EUR 1 billion. These include the increase in the general VAT rate, the reduction in spending limits provisions, and the ex-post adjustment of general funding for the wellbeing services counties under section 10 of the Act on the Funding of the Wellbeing Services Counties.

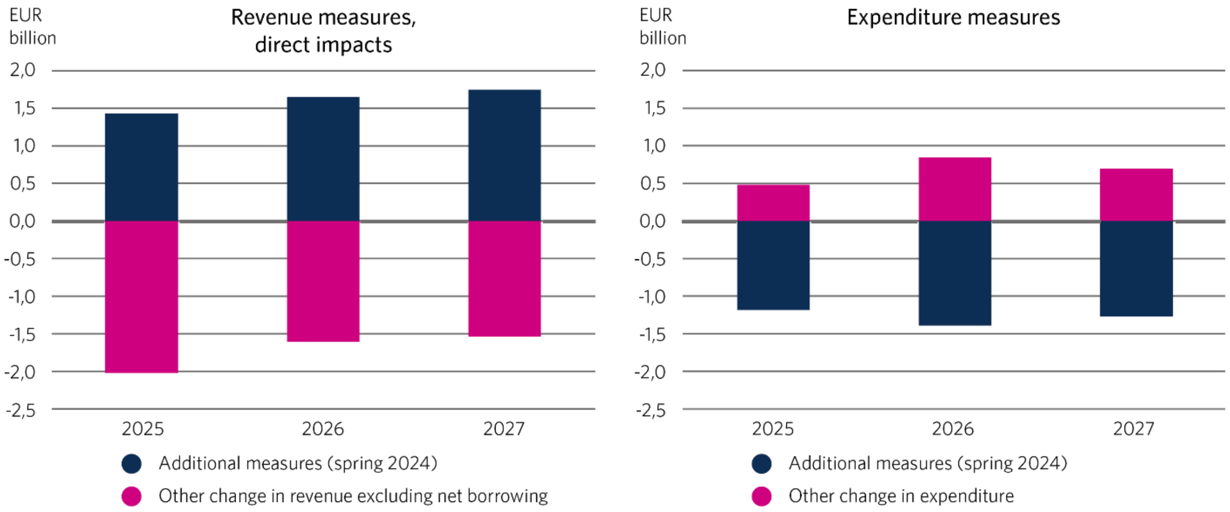

Figure 7: Changes in revenue and expenditure compared with the previous spending limits. Source: spending limits decision 2024 of on-budget activities and calculations by the fiscal policy monitoring function.

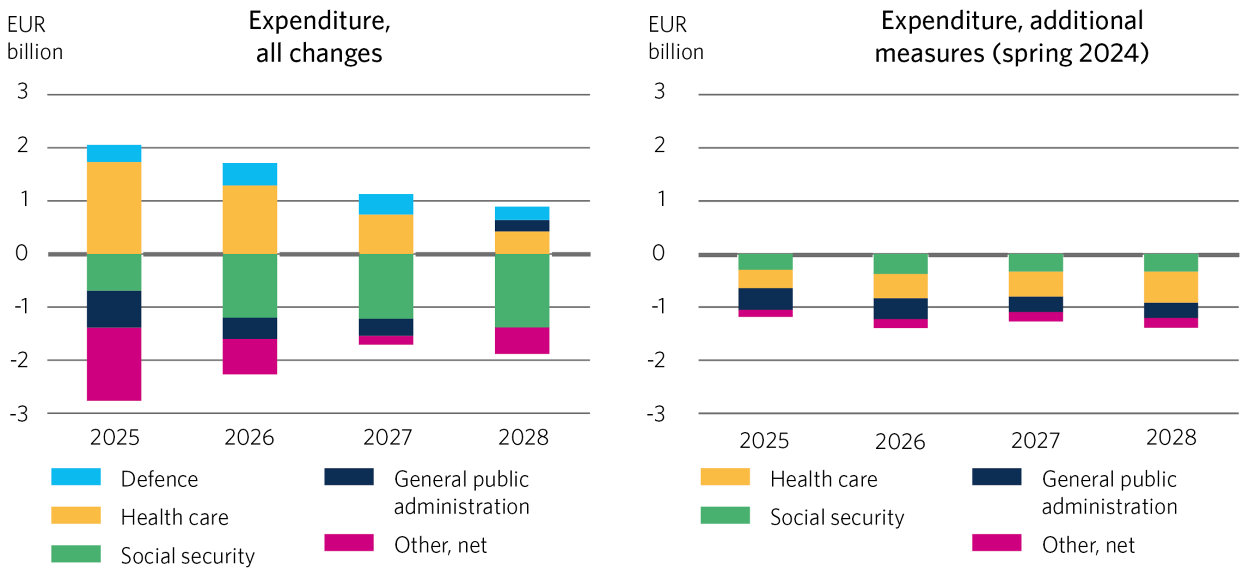

Figure 8: The allocation of expenditure changes to activities in the spring 2024 spending limits decision of on-budget activities. All changes in expenditure are shown on the left. The additional measures taken in spring 2024 are shown on the right. Source: spending limits decision 2024 of on-budget activities and calculations by the fiscal policy monitoring function.

As the target of strengthening public finances is still substantial, it is good that the range of measures was expanded in spring 2024. It is a political choice whether revenue or expenditure measures are used for the consolidation. From the perspective of economic theory, the measures should, on the one hand, distort the functioning of the market as little as possible and, on the other hand, remedy market failures as efficiently as possible. However, it should also be kept in mind that the government may fail for several reasons. These include, for example, a less efficient solution and problems with political decision-making, such as slowness and resulting delays in implementation, as well as solutions that result from political compromises and are not economically sensible.

It is also possible to make decisions on additional measures taking into consideration the historical development of general government revenue and expenditure. In Finland, since the financial crisis, expenditure pressures on public finances have been caused by the fact that especially pension expenditure and the purchasing costs of goods and services for the local government have increased faster than GDP (see chapter 1.2). At the same time, general government revenue has remained at a relatively[19] high level in international comparison and relatively stable in relation to GDP. In other words, the revenue generation capacity of the economy has remained stable when the economic growth has been slow, but the expenditure level has risen rapidly. Despite the adjustment measures now decided, the general government debt ratio in Finland is forecast to increase in the long term (Ministry of Finance, 2024c, p. 112). The question is whether measures should be directed to a greater extent at the causes for spending needs (e.g. ageing) in order to better control the growth of Finland's general government debt-to-GDP ratio in the long term. It is also worth adding that although earnings-related pension funds have not caused the increase in general government debt, their surplus is declining as a result of the rapid increase in pension expenditure (see chapter 1.2). Against this background, the current Government's statement in the Government Programme concerning the preparation of amendments to the legislation on earnings-related pensions in order to ensure the sustainability of the funding can be considered justified.

The EUR 9 billion adjustment targeted by the Government includes the adjustment presented in the Government Programme (EUR 6 billion) and the additional adjustment measures taken in spring 2024 (EUR 3 billion). The sets of measures represent the impact of a limited number of measures and do not cover all of the fiscal measures affecting the general government fiscal position. It is typical that Governments take fiscal measures outside the sets of measures defined in the Government Programmes or later in the parliamentary term. Even if the sets of measures defined by the Government were implemented in full, the expenditure measures and the tax and other revenue measures taken in addition to them cause uncertainty regarding the achievement of the fiscal position target set by the Government for 2027. Since the tax policy outlined in the Government Programme allows the tax rate to decrease, the implementation of the tax policy and the investment programme may prove problematic in view of the achievement of the fiscal position target (NAOF, fiscal policy monitoring function, 2023).

According to the current information based on the General Government Fiscal Plan (Table 25 in the Plan), the measures taken in addition to the EUR 9 billion set of measures will partially offset the impact of the adjustments on public finances. Such decisions include, for example, reducing the unemployment insurance contribution and implementing the investment programme (for more details, see NAOF, fiscal policy monitoring, 2023).

According to an overall estimate based on the General Government Fiscal Plan, all of the fiscal measures will impact the general government fiscal position by strengthening public finances by EUR 4.4 billion by 2027 (Figure 9). The difference between the overall estimate and the total according to the sets of measures taken (EUR 9 billion) is considerable. The difference exists even if it is considered that the calculations of the General Government Fiscal Plan have not taken into consideration the savings of EUR 2.7 billion that, according to the Government Programme, may result from the employment impacts (EUR 1.9 billion) of structural reforms and the streamlining carried out by wellbeing services counties (EUR 0.9 billion). This means that, even if the impacts – some of which are uncertain – of the sets of measures were assumed to be realised in full, the total impacts of the fiscal decisions would fall short of the EUR 9 billion according to the sets of measures by around EUR 1.9 billion. This would require, for example, that the investment programme would not cause more expenditure in 2027 than what is based on the current decisions. The calculation also ignores the GDP-reducing impacts of the adjustment measures on public finances (see Ministry of Finance, 2024b).

[19]In Finland, the total general government revenue-to-GDP ratio was 52.6% in 2022, the fourth highest in the OECD countries (OECD, 2024b). Finland's tax rate was the third highest in the OECD countries in 2022 (OECD, 2023). Since the financial crisis, the Finnish tax rate has increased by about one percentage point.

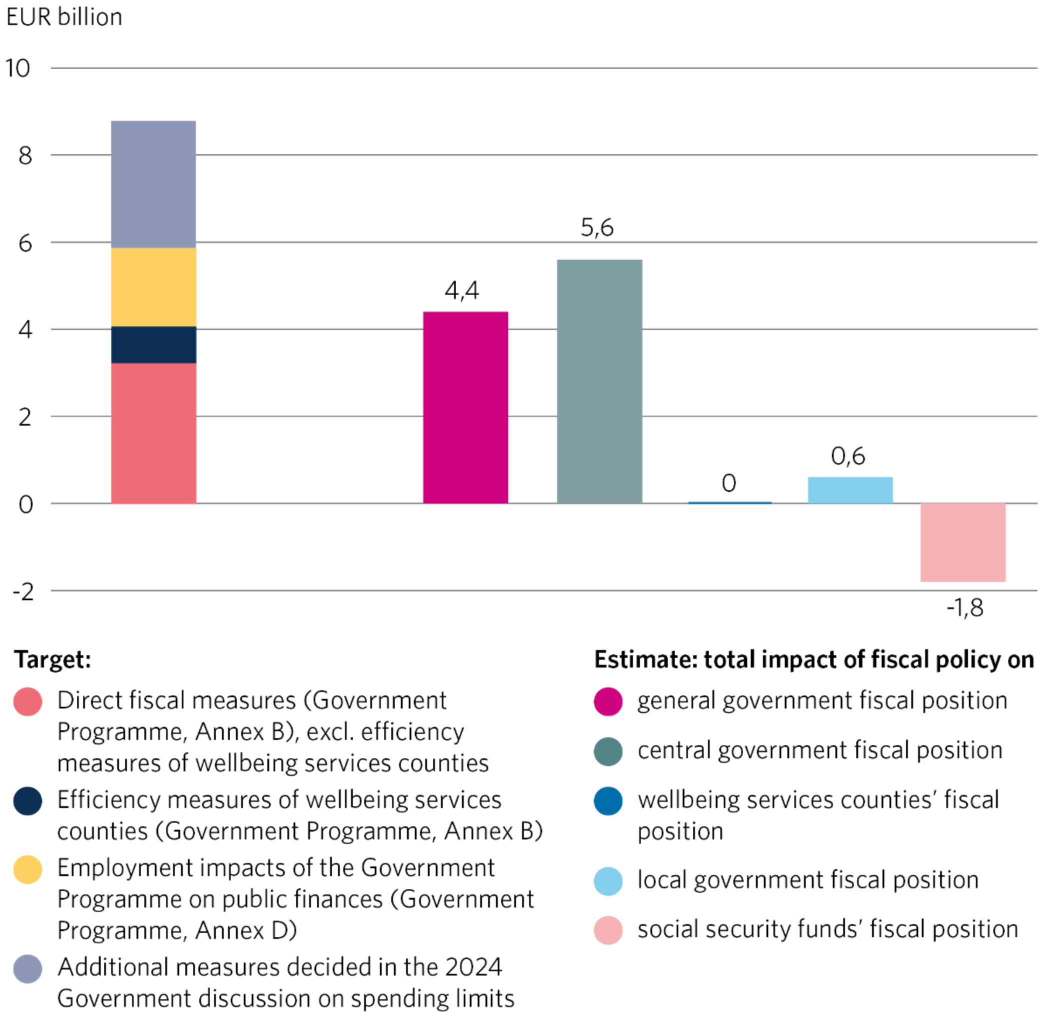

Figure 9: The EUR 6 billion and EUR 3 billion sets of measures and estimated impacts of all fiscal policy decisions on public finances in 2027 according to the General Government Fiscal Plan. Source: General Government Fiscal Plan 2025–2028.

In summary, in the light of the current forecasts, the targets set by the Government for the fiscal position and debt will not be achieved despite further measures. However, it should be noted that the parliamentary term is still in its early stages, and it is possible that the prospects for achieving the objectives will change as the parliamentary term progresses. It is important that the Government monitors the situation during the parliamentary term and takes further measures, if necessary.

2.2 The Government has tightened the spending limits, but additional expenditure under the investment programme has not been included in full in the spending limits

The fiscal policy monitoring function of the National Audit Office monitors compliance with the central government spending limits. The starting point for the calculation of compliance with the spending limits is the expenditure ceiling decided by the Government in the first General Government Fiscal Plan (GGFP). By monitoring compliance with the spending limits, it can be ensured that the expenditure ceiling is not actually raised during the government term, but that it, in line with its objective, limits the total amount of expenditure to be borne by taxpayers. In the Government Programme, the Government targeted a EUR 1.5 billion reduction in spending limits expenditure at the level of 2027. After the spring 2024 Government discussion on spending limits, the spending limits were tightened, and therefore the savings target of EUR 1.5 billion will be exceeded according to the calculations made at this stage. However, it is not yet possible to get an overall picture of the Government's expenditure decisions, as the spending limits calculation lacks most of the expenditure under the EUR 4 billion investment programme, the timing of which is likely to raise the spending limits the most in 2026 and 2027. A total of EUR 653 million of the investment programme expenditure has, to date, been taken into account in the calculation.

Some changes have been made to the expenditure items of the spending limits decided in the first General Government Fiscal Plan of Orpo's Government. Some of the changes are due to the fact that the level of spending limits expenditure was raised in the autumn 2023 spending limits decision by an amount corresponding to the savings to be made in accordance with the Government Programme outside the spending limits in unemployment security, housing allowance, and social assistance. As the savings calculations and the timing of the legislative proposals have been specified, some of these planned savings have been cancelled[20], and therefore the savings should be directed at spending limits expenditure. In addition, during the April 2024 Government discussion on spending limits, the Government decided on savings and, in the same connection, it decided to reduce the supplementary budget provision available to the Government.

As the Government's spending limits decision has been subject to exceptional changes, the fiscal policy monitoring function presents these changes in the information on the spending limits. Table 1 presents the information on the central government spending limits in such a manner that the information that has changed is marked with red. The fiscal policy monitoring function does not have a different view with the Ministry of Finance on the total amounts of the spending limits calculations, i.e. the technical spending limits, the spending limits set in the Government's first General Government Fiscal Plan, or the current spending limits, taking into account the second supplementary budget for 2024 and the changes in the General Government Fiscal Plan. However, for the entire Government term, the fiscal policy monitoring function reports the supplementary budget provision and the savings decided in Annex 6 of the Government Programme to be made to unemployment security, housing allowance, and social assistance in a different part of the calculation than the Ministry of Finance. Furthermore, the reduction in the spending limits related to an unallocated reserve has been aggregated as part of the general reduction in the spending limits. The aim is to increase the transparency and clarity of the impacts of Government decisions in relation to the expenditure items within the spending limits.

[20] These include, for example, the postponement of the Government proposals on changes related to housing allowances paid for owner-occupied housing, job alternation leave, and the staggering of unemployment security, as well as the specification of the savings calculations in relation to changes in housing allowance and the housing expenditure eligible for social assistance.

Table 1: The spending limit decisions taken during Orpo's government term and the calculation of overall compliance with the spending limits until the General Government Fiscal Plan of April 2024 and the second supplementary budget for 2024. The row marked with * shows the initial spending limits decided in the Government Programme but is not included in the calculation of the spending limits illustrated in the table. The key subtotals of the calculation are shown on a dark blue background, while items included in them are shown on a lighter background. Source: Ministry of Finance, calculations by the fiscal policy monitoring function.

Calculation method of the National Audit Office	2024	2025	2026	2027
Technical spending limits	**74,840**	**75,473**	**75,382**	**75,541**
Spending limits expenditure according to the Government Programme, total	-232	409	-238	-1,051
– savings	-837	-1,356	-1,768	-2,389
– additional expenditure	385	635	710	787
– increase in the wellbeing services counties' spending limits provision	-	680	340	-
– unallocated reserve	120	150	180	250
– supplementary budget provision	100	300	300	300
Transfer to spending limits of previous parliamentary term's compensation for municipalities' tax revenue losses	275	275	275	275
Transfer of National Housing Fund grants to the spending limits	98	98	98	98
Transfer of Makera grants to the spending limits	10	10	11	11
Preparedness for unforeseen expenditure needs	42	127	130	244
Baseline level of the spending limits of the parliamentary term, original in accordance with the Government Programme*	**75,398**	**76,499**	**75,766**	**75,225**
Baseline level of the spending limits of the parliamentary term framework, includes GGFP 2025–2027 and supplementary budget 2 for 2024	**75,034**	**76,392**	**75,659**	**75,118**
Structural adjustments, total	**39**	**-609**	**-119**	**-168**
Changes in justifications	-	-19	-4	4
Technical adjustments (timing change, re-budgeting, pass-through item, technical change)	-204	-487	-89	-174
Assistance to Ukraine (new decisions)	60	75	124	171
Investment programme	349	110	107	87
Funding of the wellbeing services counties	-204	-288	-256	-256
Use of the unallocated reserve carried over from the previous year	38	-	-	-
Total price and cost adjustments (incl. exchange rate losses)	**240**	**1,582**	**1,564**	**1,549**
Reduction in the spending limits	**-**	**-627**	**-787**	**-823**
Updated spending limits for the parliamentary term, includes GGFP 2025–2027 and supplementary budget 2 for 2024	**75,312**	**76,738**	**76,317**	**75,676**
Budgeted within the spending limits	**74,975**	**-**	**-**	**-**
Not budgeted within the spending limits	337	-	-	-
Budgeted outside the spending limits	**13,022**	**-**	**-**	**-**
Total amount budgeted	**87,997**	**-**	**-**	**-**

In the spring 2024 government discussion on spending limits, savings totalling EUR 1.133 billion were decided for 2025, and these were combined with a EUR 430 million reduction in the spending limits. This means that of the new appropriation cuts, EUR 430 million also reduces the total central government expenditure level, while EUR 730 million of the cuts constitutes reallocation within the spending limits, whereby expenditure within the spending limits grows at the same time by a corresponding amount. The Government also made decisions on additional expenditure, of which the expenditure related to the investment programme and support for Ukraine raise the spending limits in a way that also increases the total amount of expenditure to be borne by taxpayers. In the April 2024 Government discussion on spending limits and the supplementary budgets for 2024, a decision was made on an annual increase of EUR 7 million to the investment programme and on EUR 7 million for 2024 and EUR 30 million for 2025 for supporting Ukraine. In total and compared with the General Government Fiscal Plan of autumn 2023, following the decisions taken in the Government discussion on spending limits and price adjustments, the appropriations within the spending limits increased by around EUR 153 million, with expenditure cuts totalling EUR 2.8 billion and expenditure increases totalling around EUR 3 billion.

The Government had originally justifiably reserved a larger margin than before for new expenditure decisions, as the spending limits included an annual supplementary budget provision of EUR 400 million. Moreover, as regards the transparency of the spending limits decision, it is good that Table 7 of the General Government Fiscal Plan of autumn 2023, which describes the spending limits decision, includes a separate growing unallocated reserve. This was also in line with the views of the working group on the development of the steering of general government finances (Ministry of Finance, 2022). However, with the new decisions, the Government reduces the margin available to it by a total of EUR 300 million in 2024, EUR 297 million in 2025, EUR 275 million in 2026, and EUR 431 million in 2027.

Figure 10 shows the changes made in the spring 2024 Government discussion on spending limits to the spending limits expenditure of the different administrative sectors compared with the previous General Government Fiscal Plan, published in October 2023. In the figure, only the changes in spending limits expenditure are examined, and the appropriations of the President of the Republic and Parliament are excluded from the main titles because of their small amount. The numbers in the figure also include the savings on the operating expenditure of the different administrative sectors under the productivity programme.

Figure 10: The share of the savings (-) and increases (+) decided in the General Government Fiscal Plan of spring 2024 compared with the General Government Fiscal Plan of autumn 2023. The information is presented relative to the spending limits expenditure of the administrative sector as specified in the General Government Fiscal Plan of autumn 2023.

In the 2024 General Government Fiscal Plan, the most significant reductions in appropriations compared with the previous General Government Fiscal Plan were directed at the administrative sectors of the Ministry for Foreign Affairs, the Ministry of Social Affairs and Health, and the Ministry of the Interior. In the case of the Ministry for Foreign Affairs, the reduction in the level of appropriations is mainly due to appropriations allocated at actual development cooperation. These will be reduced from EUR 630 million to EUR 550 million by 2027. The appropriations of the Ministry of Social Affairs and Health will also be reduced significantly due to the reduction in the statutory government contribution to the expenditure under the Health Insurance Act. The cuts will reduce the expenditure of the Social Insurance Institution of Finland (Kela), whereby corresponding savings will be channelled to the central government. In addition, the reduction of the appropriations of the Ministry of the Interior in 2025 is mainly due to the reduction of the Finnish Border Guard's investment appropriations by EUR 72 million.

As a result of the changes made to the housing allowance for students, its funding has been transferred from outside the spending limits to the spending limits expenditure of the administrative sector of the Ministry of Education and Culture, which explains the increases in expenditure. In addition, in 2025, the statutory government contribution to the operating costs of pre-primary and basic education and early childhood education was increased by around EUR 100 million. In relation to the spending limits expenditure of the administrative sectors, the biggest increases in expenditure are directed at the administrative sector of the Ministry of Defence, whose expenditure is increased particularly by defence materiel procurement and the procurement of multi-role fighters. The most significant increase in the appropriations of the Ministry of Economic Affairs and Employment is scheduled for 2027, mainly due to the additional support for research, development, and innovation by a total of EUR 125 million in 2027. In addition, the statutory government contribution to the EU's cohesion policy programmes has been increased.

2.3 The fiscal policy is appropriate for the short-term business cycle – its stance and impulse are counter-cyclical

The difference between general government revenue and expenditure, excluding gross interest payments, and its cyclically adjusted ratio to GDP (i.e. structural primary balance) remain negative in 2024 and 2025. In other words, the fiscal stance continues to stimulate the economy counter-cyclically in 2024 and 2025 when the business cycle is weaker than the long-term average (average growth). This is the situation with regard to the fiscal stance, even though the Ministry's fiscal balance forecast includes the additional savings decided by the Government in the spring. The fiscal impulse, i.e. the change in structural primary balance in relation to GDP, will be contractionary in 2025, as the business cycle improves from the previous year.

When fiscal policy is adjusted appropriately to the business cycle, public finances support economic activity during a downturn and accumulate fiscal buffers and curb economic overheating during an upturn. In other words, general government revenue and expenditure and their difference (fiscal balance) should be counter-cyclically proportional to the business cycle in the whole economy. The examination of the fiscal stance of statistical years 2022–2023 is based on the difference between general government revenue and expenditure according to the National Accounts, excluding gross interest payments (nominal primary balance), and in the case of years 2024–2025, on the independent forecast of the Economics Department of the Ministry of Finance for its development[21].

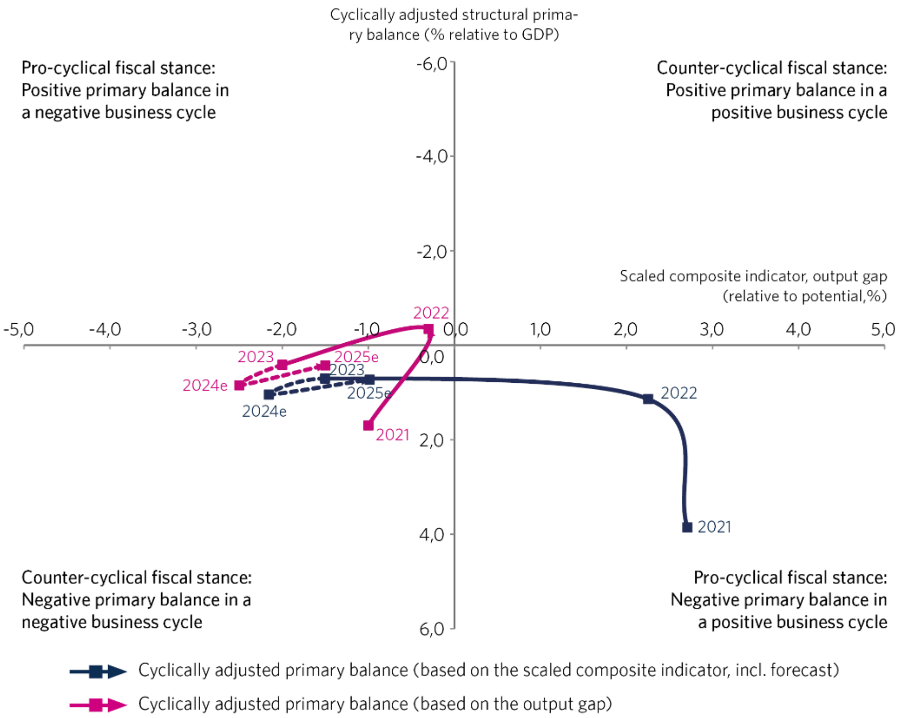

Figure 11: Fiscal stance in relation to the business cycle: structural primary balance based on the output gap and the business cycle indicator of the heatmap in relation to the business cycle based on the output gap and the business cycle indicator of the heatmap in 2021–2025. The primary balance has been cyclically adjusted by means of both the output gap (pink dots) and the composite indicator of the heatmap (blue dots). The variation (standard deviation) of the business cycle indicator of the heatmap has been scaled to be comparable with the variance (standard deviation) of the output gap. (See Strifler and Kokkinen, 2021c) The estimates of both the business cycle and the cyclically adjusted structural primary balance based on the output gap method may be revised later even to a significant extent. Source: Ministry of Finance and the fiscal policy monitoring function.

[21] It should be taken into consideration that some of the fiscal measures decided by the Government in the Government Programme and in the Government discussions on spending limits in autumn 2023 and spring 2024 are such that their impacts on the balance of general government finances cannot be verified directly. All of these measures are not included in the independent forecast for the primary balance.

Structural primary balance relative to GDP is achieved when the impact of cyclical fluctuations is excluded from nominal primary balance relative to GDP. In other words, in addition to the nominal primary balance relative to GDP, the examination of the appropriateness of the fiscal stance is, in practice, influenced only by the picture of the business cycle.

As the business cycle estimate plays a key role in the assessment of the fiscal stance, the business cycle in Finland is assessed in the reports of the fiscal policy monitoring function based on two different business cycle indicators: 1) the composite heatmap indicator that is produced by the fiscal policy monitoring function and that is compiled directly on the basis of business cycle indicators (and their forecasts) and 2) the difference, or gap, between the EU Commission's estimate of potential output (and the forecasts of the Ministry of Finance) and observed GDP. The business cycle estimate (i.e. the gap between estimated long-term potential GDP and observed GDP) is obtained indirectly here.

In 2023, 2024 and 2025, the estimates of the business cycle based on these two business indicators converge again (Figure 11, points in the horizontal axis) after the differences in 2021 and 2022. Both methods produce now the same assessment of the appropriateness of the fiscal stance for the business cycle in 2023–2025: the fiscal stance (Figure 11, points in the direction of the vertical axis compared with the business cycle on the horizontal axis) is seen as slightly counter-cyclical, supporting the economic activity in a business cycle that is weaker than the long-term average (average growth).

The change in fiscal policy in 2024 seems to continue to give a counter-cyclically stimulating impulse to the declining economy (Figure 12). In 2025, the fiscal impulse to the total economy is contractionary, which may prove to be appropriate in view of the business cycle if economic growth turns positive as projected.

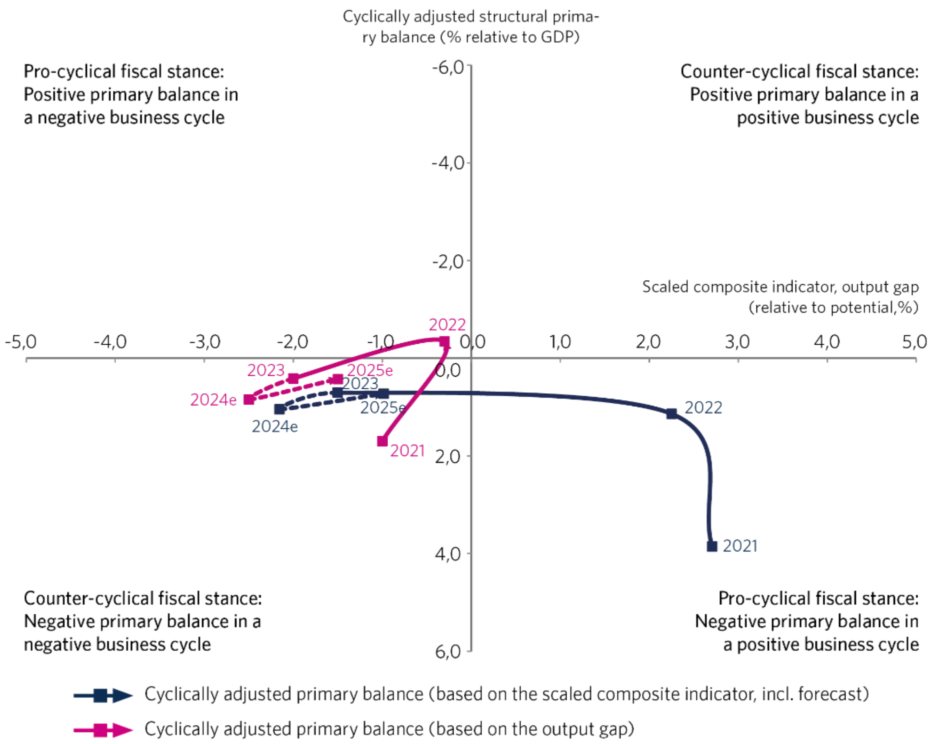

Figure 12: Fiscal impulse in relation to the change in business cycle: the change in structural primary balance (cyclical adjustment based on the output gap and the composite indicator) in relation to the change in both the output gap and the composite indicator produced by the fiscal policy monitoring function. The estimates for 2024 and 2025 are based on forecasts. Source: Ministry of Finance and the fiscal policy monitoring function.

As stated above, the choice of the cyclical adjustment method may have a significant impact on the understanding of the fiscal stance and its appropriateness for the business cycle. In addition, in the case of the current and future years, the estimate of the general government structural balance is affected by the different forecasts of the nominal general government deficit. This effect can be illustrated by using, in addition to the Ministry of Finance's forecast for the nominal deficit, consensus forecasts formed by means of the forecasts of a wider range of forecasters (see section 1.3).

In the comparison presented in Figure 13, the differences in actual data (2006–2023) are due to the different cyclical adjustment methods used, and the differences in forecast years (2024 and 2025) are also related to differences in nominal deficit forecasts.

Based on the information provided by the Ministry of Finance, the general government structural balance in 2022 was, for the first time since the financial crisis of 2008–2009, stronger than the medium-term objective of -0.5% of GDP (Figure 13). Thereafter, according to the Ministry's estimate, the structural balance weakened sharply in 2023. According to the forecast of the Ministry of Finance, the weakening will continue but be less sharp in 2024, and the structural balance will slightly strengthen in 2025. However, when calculated according to the cyclical adjustment method used by the fiscal policy monitoring function, the structural balance of 2022 did not reach the target of -0.5% of GDP. In other words, according to the assessment of the fiscal policy monitoring function, fiscal policy was more flexible in 2022 than estimated by the Ministry of Finance.

In 2023, the weakening of the structural balance, calculated using the cyclical adjustment method of the fiscal policy monitoring function, was considerably less sharp than in the Ministry's assessment. The picture that the two analyses provide of the development of general government finances differs much less for 2024 and 2025: the development of the structural balance, based on the consensus forecast and the business cycle indicator of the fiscal policy monitoring function, is relatively close to the estimate of the Ministry of Finance. In autumn 2023, there were still considerable differences between the estimates for 2024.

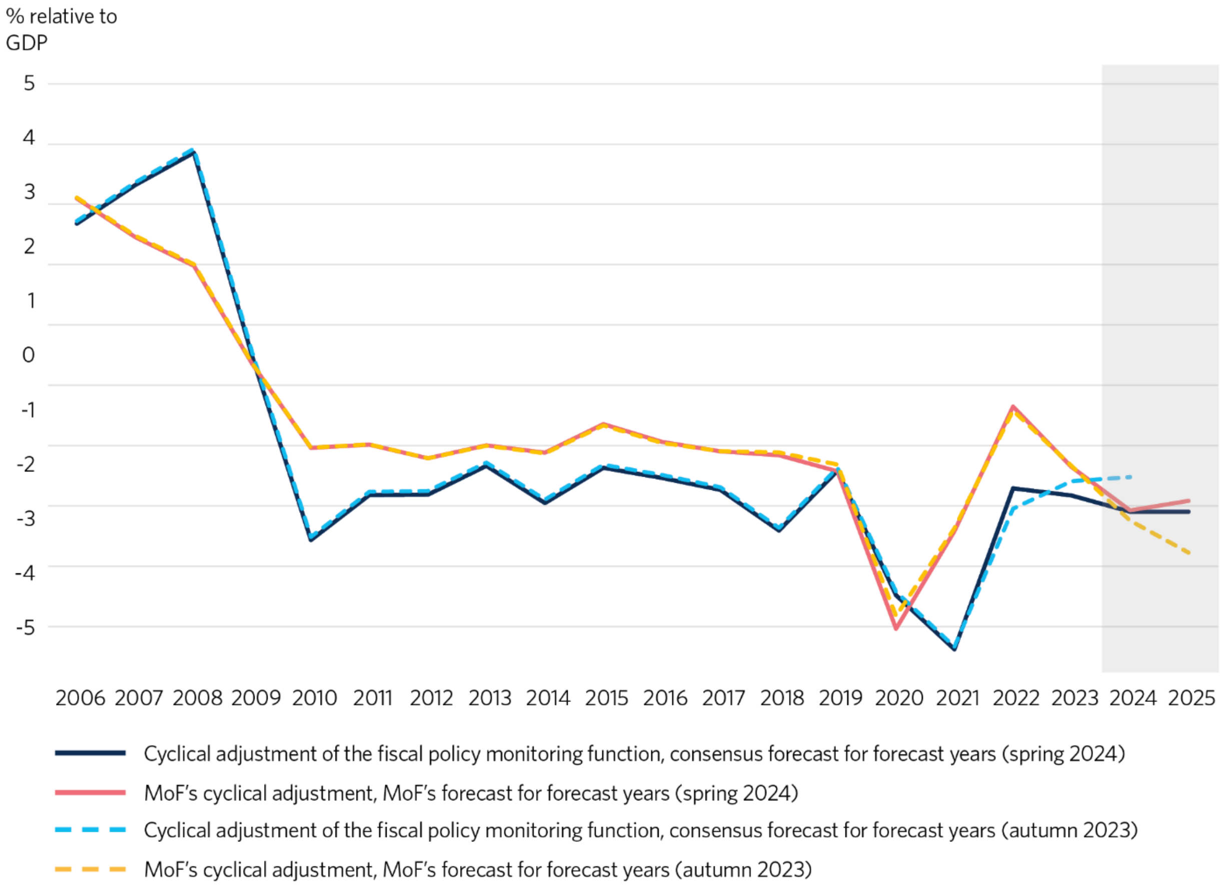

Figure 13: Development of the general government structural balance, including forecasts, between 2006 and 2025. Source: General Government Fiscal Plan 2025–2028 (Ministry of Finance, 2024) and the fiscal policy monitoring function.

2.4 The Government's employment measures have progressed rapidly

The Government of Prime Minister Petteri Orpo is committed to achieving 100,000 new employed people by 2027 by means of structural measures as part of the more extensive objective of strengthening public finances during this parliamentary term. The aim is to achieve savings of EUR 2 billion at the 2027 level through the (dynamic) impacts of these structural measures, resulting from new employed people (Finnish Government, 2023). It is important that the Government Programme has a concrete employment target for which the Government takes structural policy measures. Given the rapid increase in general government debt in Finland, it is good that the employment measures have also been linked with a fiscal target in euros (NAOF, fiscal policy monitoring function, 2023). It should be kept in mind that the fiscal target concerns the dynamic impacts of the measures. It is also important to monitor the total impact of the measures on public finances. The Ministry of Finance assesses the impacts of the structural policy measures taken by the Government on employment and public finances. The implementation of the employment measures will be monitored on the basis of the Ministry of Finance's assessments during the parliamentary term, and the Ministry, in cooperation with other ministries, will draw up assessment memoranda on the measures. Differing figures, “scenario calculations”, or “employment potentials” have not been published. This makes it easier to monitor the calculations of the measures and the achievement of the objectives.

The Government measures decided by May 2024 include several reforms related to unemployment security, social security, and other benefits. The Government has prepared measures rapidly and has already submitted proposals for structural policy measures to Parliament. Key measures include “freezing certain social security benefits at the 2023 level” (HE 75/2023; 18,600 new employed people), “staggering the level of earnings-related daily allowance” (HE 13/2024; 12,800 new employed people), and “abolishing adult education allowance” (HE 8/2024; 10,000 new employed people).

On 5 April 2024, the Ministry of Finance published a summary of the Government's employment measures (Ministry of Finance, 2024a). According to this estimate, the total number of new employed people resulting from the measures decided so far is 74,100. According to the memorandum, the (dynamic) impact of these measures on public finances, resulting from the number of new employed people, totals approximately EUR 1.7 billion. It is good that the Ministry publishes memoranda and status reports on the calculations and actively monitors the achievement of the target. However, all key figures related to the calculations cannot be found in government proposals. The Government should ensure that all impact assessments and the figures needed to repeat the calculations are found in government proposals. In that case, a rough repetition of the calculations with the information provided in the government proposals would also be possible and it would be easier for Parliament to discuss the government proposals.

The calculations by the Ministry of Finance are mainly based on justified assumptions and academic literature. Nevertheless, the calculations involve considerable uncertainty, as the Ministry also emphasises. In order to understand the uncertainty, the fiscal policy monitoring function monitors the calculations of the Ministry of Finance and produces upper and lower bounds for the impact estimates by means of a technical sensitivity analysis (Appendix 4, Figure 14). The analysis produced here is of a technical nature, and the bounds for the employment impacts of structural policy measures, for example, should not be interpreted as a confidence interval.

The sensitivity analysis highlights the impacts of two sources of uncertainty on the estimates. The first relates to the elasticities underlying the calculations of the employment impact of the measures. The elasticity indicates the extent to which the target group of a certain measure reacts to a change in a benefit, for example (see Appendix 5). In the calculations, the Ministry of Finance relies on the best available information on the elasticites. Nevertheless, greater emphasis should still be placed on the uncertainty that the elasticity involves. The upper and lower bounds of the employment impact have been calculated by increasing and reducing the elasticities used in the calculations by 10%.[22]

[22]However, the upper and lower bounds of the employment impact are not entirely symmetrical, because, in the case of index freezing of social security benefits, the imputed change in the participation tax rate (i.e. how much of the additional gross revenue is offset by taxes and reduced benefits when a person moves from outside the labour market to employment) depends on the actual inflation in the coming years. The impact of the index freeze is limited according to the Ministry of Finance's estimate that the participation tax rate may decrease by a maximum of 4.6%. In our examination, we use a change of 4.6% at the upper bound and otherwise a change of 4.2%.

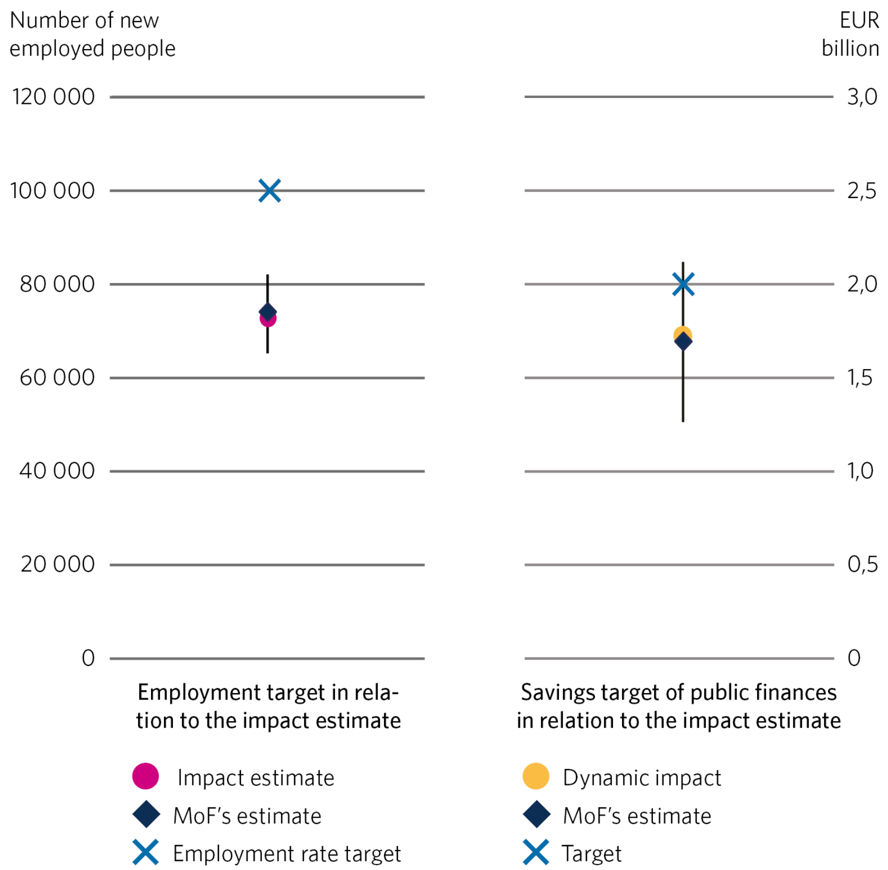

Figure 14: Targets and impact estimates of the Government's structural policy measures. Source: Government Programme 2023, Ministry of Finance 2024, and the fiscal policy monitoring function.

Another essential source of uncertainty is the extent to which one new employed person strengthens public finances. There are many different ways of estimating this (Seuri, 2020). The estimate will have a significant effect on the impact of the measures on public finances and on the monitoring of the achievement of the target (see NAOF, fiscal policy monitoring function, 2020 and 2022). According to Seuri, the impact of one new employed person on public finances is EUR 18,000–23,000 per year, and the estimate used by the Ministry of Finance during the last parliamentary term was approximately EUR 21,500–23,000 (NAOF, fiscal policy monitoring function, 2020). The impact per new employed person used by the Ministry of Finance in the sensitivity analysis of the sustainability gap is EUR 24,000–25,000 per year.

The calculations have been made from fundamentally different perspectives, and the impact on public finances per new employed person presented in them is therefore different. It is important to bear this in mind in the monitoring of the impacts of the measures and in the formulation of the employment target (NAOF, fiscal policy monitoring function, 2020). It is good that the Ministry of Finance, at the beginning of the parliamentary term, published a background memorandum that presents an updated estimate of the impact of one new employed person on public finances. According to it, the impact per new employed person is EUR 26,200. The estimate has grown significantly, mainly because the background data have been updated (Ministry of Finance, 2023). In order to highlight the uncertainty associated with this estimate and to enable comparison with the impacts of the measures taken during the previous parliamentary term, we use the following assumptions in the technical sensitivity analysis: the lower bound of the impact of one new employed person on public finances is assumed to be 80% of the current estimate (EUR 20,960), and the upper bound is assumed to be 110% of the estimate (EUR 28,820).

According to the calculations by the fiscal policy monitoring function, the total employment impact of the measures is 72,800 new employed people, which confirms the estimate published by the Ministry of Finance (Figure 14, Appendix 4). The lower and upper bounds of the total employment impact are 65,200 and 82,100, respectively. According to calculations by the fiscal policy monitoring function, the total dynamic impact of the measures on public finances is EUR

1.7 billion, which corresponds to the figure published by the Ministry of Finance (Appendix 4). The lower and upper bounds of the dynamic impact of the structural policy measures are EUR 1.3 billion and EUR 2.1 billion, respectively. In addition to the dynamic impact, it is important to consider the total (dynamic + static) impact of the measures on public finances. The total impact is estimated at around EUR 2.5 billion, and the related lower and upper bounds are EUR 2.0 and 2.9 billion, respectively. The Government has achieved approximately 73% of the employment target and 86% of the objective of strengthening general government finances. The Government's employment measures have thus progressed rapidly, and, on the basis of the ex-ante calculations, the targets have been met to a large extent.

It should be noted that the Ministry of Finance's calculations and the estimates produced in this report are ex-ante estimates. It is therefore not certain that these estimates will be realised as such.[23] In the absence of suitable reference groups, it is very difficult, if not impossible, to produce high-quality ex-post assessments. It should also be noted that it seems that part of the impacts of the measures will only be seen in years following the parliamentary period. It is recommended that the Government should continue to consider ways of strengthening the sustainability of public finances in view of the rapid increase in Finland's general government debt, the low employment rate in Finland compared with other Nordic countries, and the uncertainty associated with the final impacts of the measures.

[23]Ex-ante and ex-post assessments may differ, for example, when excessive adjustment measures in a weak business cycle cause permanent damage to the economy (so-called hysteresis). In relation to this, see Cerra et al. (2023) and Furlanetto (2024).

3 Reform of and compliance with the EU fiscal rules

3.1 The reform of the EU fiscal framework has entered into force.

The reform of the EU fiscal framework entered into force on 30 April 2024. The European Parliament adopted the regulation on the preventive arm of the Stability and Growth Pact on 23 April, after which the EU Council adopted the entire reform package April 29. The reference values for general government deficit and debt included in the corrective arm of the Stability and Growth Pact remained unchanged in the reform. A key element of the reform is that compliance with the rules is no longer monitored on the basis of general government structural balance relative to GDP. In addition, if the debt-to-GDP ratio exceeds 60%, the debt ratio is no longer monitored directly when compliance with the debt criterion is assessed. These will be replaced by monitoring a net expenditure path specific for each Member State. The net expenditure path is defined on the basis of debt sustainability analysis and so-called safeguards for countries whose government debt exceeds 60% or whose deficit exceeds 3% relative to GDP.

Net expenditure is calculated as total public expenditure net of interest payments, cyclical unemployment expenditure, and expenditure of EU programmes, in addition to which one-off items and the impact of discretionary revenue measures are also considered (Figure 15). In practice, considering discretionary revenue measures means, for example, that tax increases give a Member State more space for expenditure growth. Tax reductions, in turn, are reflected in the indicator as expenditure growth, whereby they reduce the space for actual expenditure. The content of net expenditure largely corresponds to the expenditure benchmark used in the old framework, but its application changes considerably. In the old framework, the development of the expenditure benchmark was compared with the growth rate of potential output, whereas in the new framework, net expenditure is monitored directly in relation to the path set for its development.

Net expenditure

= Total general government expenditure
- Interest payments
- Cyclical unemployment expenditure
- Discretionary tax and other revenue measures
- Expenditure on EU programmes
- One-off items

Figure 15: Definition of net expenditure in the reformed EU fiscal framework (Regulation 2024/1263).

The Member States will submit their first fiscal-structural plans to the Commission in autumn 2024. As part of the plan, a Member State presents its net expenditure path for the next four years. The Member State can apply for an extension of up to three years for the adjustment period. Before the plans are drawn up, by 21 June, the Commission will provide the Member States with so-called reference trajectories for the development of net expenditure. They are based on Member-State-specific debt sustainability analysis and on deficit and debt sustainability safeguards. The Commission's reference trajectories serve as a basis for Member States' plans and discussions with the Commission. Based on this, the Member State forms and presents a net expenditure path, which is then evaluated by the Commission and approved by the Council as part of the fiscal-structural plan.

The net expenditure path, which is included in the new framework and based on debt sustainability analysis, can provide a good basis for a realistic fiscal policy that takes the debt ratio in a favourable direction. This is because the Government has better opportunities to influence net expenditure than public debt, deficit, or their GDP ratios. However, a major challenge is that compliance with the net expenditure path does not automatically mean that the debt ratio is reduced, as the debt ratio is also affected by other factors. The debt sustainability analysis, on which the setting of the net expenditure path is based, is built on assumptions made about several factors affecting the debt ratio. If the actual development of these factors does not correspond to the assumptions made when the net expenditure path was set, the debt-to-GDP ratio will not develop as originally estimated, either, even if the net expenditure rule were complied with. The problem concerns, for example, revenue items that are not included in the net expenditure indicator. If general government revenue develops unfavourably compared with expenditure (and differently from the assumptions made when the net expenditure path was set) as a result of measures other than the government's new discretionary measures, it is possible that expenditure and revenue develop independently of each other, and compliance with the expenditure path no longer guarantees a reduction in the debt-to-GDP ratio (see Larch & Malzubris, 2023). Due to major uncertainties, it will not be possible to draw conclusions on the functioning of the framework until experience has been gained of its application. The content of the reform was presented and assessed in greater detail in the fiscal policy monitoring report 2023 (NAOF, fiscal policy monitoring function, 2023).

In the EU's reformed fiscal policy framework, debt sustainability analysis[24] aims to ensure that the selected fiscal policy adjustment path will put the debt ratio plausibly on a downward trajectory. The debt ratio must remain on a downward trajectory even if the economic situation weakened unexpectedly. Unforeseen changes in the main variables affecting the debt ratio are taken into account in the debt sustainability analysis by means of various adverse scenarios.

The safeguards applied in the debt sustainability analysis may play a significant role for Finland when the future adjustment need is determined. The safeguards set strict numerical criteria for deficit and the debt ratio, and an acceptable adjustment path must fulfil these criteria. According to preliminary estimates, the new framework requires Finland to significantly strengthen its public finances (Keskinen, 2024a, 2024b). According to the Ministry of Finance's latest forecast, the general government debt-to-GDP ratio will grow in the next few years whereas the debt sustainability safeguard under the new framework requires Finland's projected debt ratio to decrease by half a percentage point a year. For a country with a debt ratio similar to Finland, the safeguard means a somewhat slower adjustment pace than what the old framework required of the decrease in the debt ratio[25].

The debt sustainability analysis under the new framework will also consider one very important factor for Finland: the stock-flow adjustment. The significance of this adjustment to Finland and the other Member States was discussed in the previous fiscal policy monitoring report (NAOF, fiscal policy monitoring function, 2023). The Commission has previously assumed that the stock-flow adjustment will be zero in the medium term. In future, the country-specific characteristics of the stock-flow adjustment will be taken into account if the following three criteria are met: (i) the adjustment is systematically and significantly different from zero, (ii) the variations can be explained by structural factors, and (iii) the adjustment can be reliably forecast (European Commission, 2024). As regards the surplus of the Finnish earnings-related pension scheme, these three criteria are met. The consideration of the stock-flow adjustment in the debt sustainability analysis will contribute to tightening up the requirement for adjustment in Finland.

3.2 Finland risks breaching the reference value for general government deficit

The net expenditure path referred to in the new EU legislation has not yet been defined. Therefore, the prospects for compliance with it are not yet assessed in this report. The net expenditure rule under the new legislation will apply starting from 2025, and the net expenditure path applied to Finland will be defined in autumn 2024. Correspondingly, the report does not assess the development of general government structural balance and the debt ratio from the perspective of compliance with the fiscal rules. This is because, after the reform entered into force, these will no longer function as operational rules.

The general government deficit is subject to the 3% reference value, which continues to be in force after the reform of the rules. Finland risks breaching this reference value. According to spring 2024 estimates (Figure 16), the reference value will be broken in 2024 based on both the Ministry of Finance's forecast and the consensus forecast formed from the forecasts of other forecasters (see section 1.3). In 2025, the deficit is expected to fall again below the reference value based on both the Ministry's forecast and the consensus forecast.

[24] The debt sustainability analysis applied by the Commission and the updated stock-flow adjustment are described in more detail in sections II.1. and II.2 of Debt Sustainability Monitor 2023 (European Commission, 2024).

[25] In the old framework, the debt criterion was considered to be met if the debt-to-GDP ratio decreased sufficiently, i.e. by an average of 1/20 a year for the part exceeding the 60% reference value.

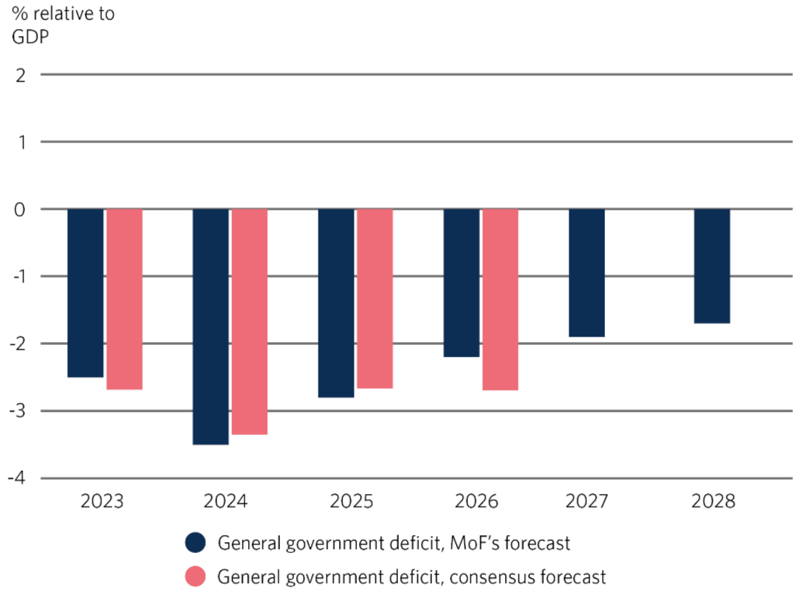

Figure 16: Development of general government deficit based on the Ministry of Finance's forecast and the consensus forecast. Source: Ministry of Finance (2024b) and the fiscal policy monitoring function.

Exceeding the deficit reference value may lead to the Excessive Deficit Procedure (EDP), which means that the Member State must adjust its public finances under the supervision of the EU Commission and Council. When assessing whether an EDP procedure is to be initiated on the basis of an actual or anticipated deficit, the Commission considers the nature of the exceeding of the reference value and examines the exceptional nature, duration, and magnitude of the exceeding. If the excess is exceptional (e.g. due to a severe recession), temporary, and minor, it is considered that, regardless of the excess, the deficit criterion has been complied with.

If the exceeding of the deficit criterion is considered to be temporary and minor, the relevant factors that have contributed to the exceeding of the reference value are taken into account in the decision-making related to the exceeding of the reference value and the existence of an excessive deficit. The relevant factors may be based, on the one hand, on matters listed directly in EU legislation and, on the other hand, on such other factors presented by the Member State that the Member State considers to have contributed to the exceeding of the reference value. The list of relevant factors grew in connection with the reform of the EU rules. In future, based on legislation, the Commission will also take the growth of investments in national defence directly into account as a mitigating factor.

The Stability Programme annexed to the spring 2024 General Government Fiscal Plan states, based on the Ministry of Finance's forecast, that the exceeding of the reference value in 2024 will be minor and temporary. In addition, the exceeding the reference value set for deficit is regarded as exceptional, as the economic growth remains negative in 2024. According to the Stability Programme, the exceeding of the reference value for deficit is explained by, for example, an exceptional increase in security-related expenditure, including supporting Ukraine. Therefore, the Stability Programme states that the deficit criterion can be considered to be met.

However, it is pointed out in the Programme that, in view of the projected deficit for 2024, the risk of Finland entering the excessive deficit procedure in spring 2025 on the basis of breach of the deficit criterion cannot be excluded. It is justified to highlight the risk, especially as the estimate is based on a deficit of 3.4% in accordance with the Government's plan and not on a deficit of 3.5% in accordance with the independent forecast for 2024 of the Ministry of Finance. Given the uncertainty of forecasts, the difference is negligible. However, even a small difference may be significant when compliance with the rule is on knife-edge. Based on the consensus forecast compiled by the fiscal policy monitoring function, the excess of the reference value in 2024 would be slightly lower than based on the Ministry's forecast.

The Fiscal Policy Act (869/2012) links the EU fiscal rules with the national legislation. It includes, for example, a provision under which, after exceptional circumstances under the EU law have ceased, the Government shall decide on measures to be taken in the same or at the latest the following calendar year to improve the general government structural balance by at least 0.5 percentage point. At the end of 2023, following the expiry of the general escape clause related to the EU fiscal rules, there are uncertainties related to the interpretation of the Fiscal Policy Act (see NAOF, fiscal policy monitoring function, 2023 and 2021). As a result of the reform of the EU rules, the contents of the Fiscal Compact have been incorporated into the EU law, and the contents of the national Fiscal Policy Act are no longer up to date: the Act contains references to EU regulations that are no longer in force. The national legislation should therefore be updated without delay.

However, the estimated total impacts of the Government's fiscal policy on public revenue and expenditure in 2024–2025 meet the criterion set by the Fiscal Policy Act, according to which an improvement of 0.5 percentage point should be achieved in structural balance relative to GDP as a result of adjustment measures. Based on the information in the General Government Fiscal Plan (Table 25 in the Plan), the impact of the fiscal measures implemented in 2024–2025 is estimated at 1.2% of GDP. The estimated impacts of fiscal decisions are therefore in line with the spirit of the Fiscal Policy Act.

Appendix 1: The composite indicator of the heatmap and output gap estimates

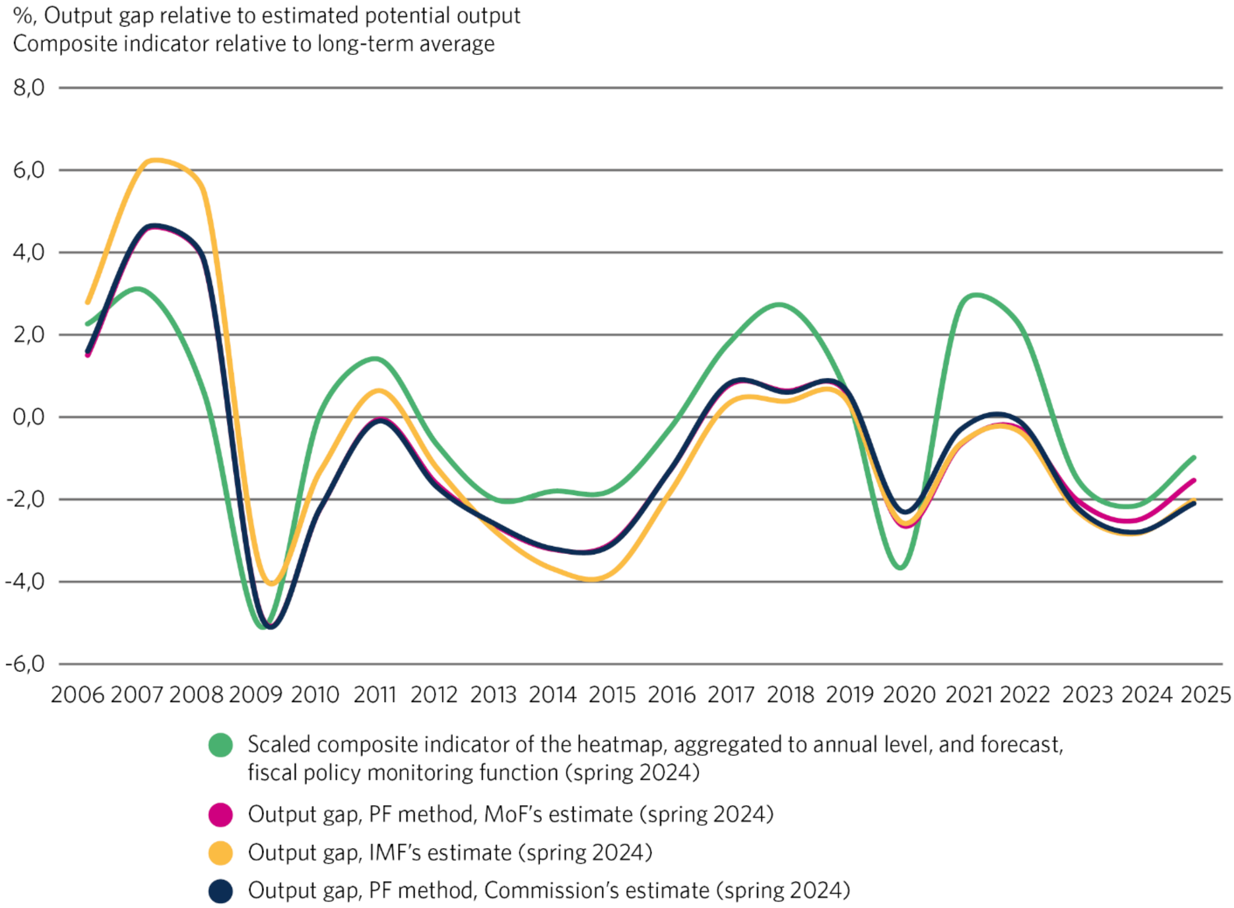

Figure 17: Scaled composite indicator aggregated to annual level and its forecast (fiscal policy monitoring function), and output gap estimates (Ministry of Finance, IMF, and the EU Commission). Forecast for 2024 and 2025. The variation (standard deviation) of the business cycle indicator of the heatmap has been scaled to be comparable with the variance (standard deviation) of the output gap. Sources: MoF, EU Commission, IMF, and the fiscal policy monitoring function.

Appendix 2: Forecasts of the Ministry of Finance, consensus forecast, and upper and lower bounds of the prediction intervals for 2024

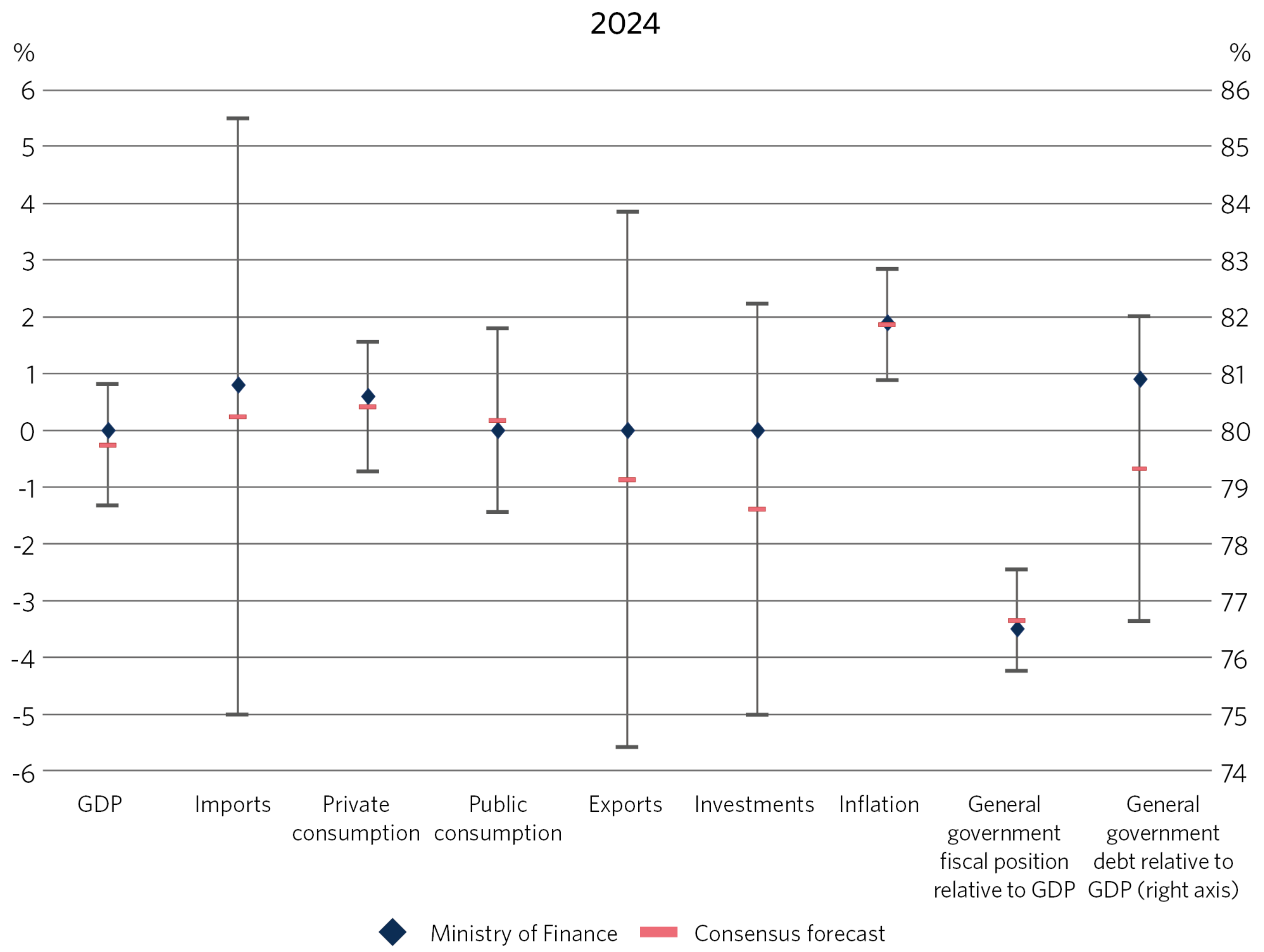

Figure 18: The Ministry of Finance's forecasts for 2024, the values of corresponding consensus forecasts on the publication date of the Ministry of Finance's forecast, and the 95% prediction intervals. Forecasts for supply and demand items are expressed as changes in volume, other forecasts as a percentage. Source: forecasters and the fiscal policy monitoring function.

Appendix 3: Observations on compliance of the General Government Fiscal Plan (GGFP) for 2025–2028 with the requirements set by the Decree on the General Government Fiscal Plan (120/2014)

Section	Requirement set by the Decree	Assessment of compliance
Section 3	The General Government Fiscal Plan shall cover all parts of general government finances. The Plan contains sections on central government finances, finances of the wellbeing services counties, municipal finances, statutory earnings-related pension funds, and other social security funds.	The coverage and structure of the Plan comply with the requirements.
Section 3	The General Government Fiscal Plan sets multi-annual objectives for the fiscal position in relation to GDP at market prices for the entire general government and, in addition, a separate objective for each sub-sector of general government listed in paragraph 1. The fiscal position objectives shall be set in such a manner that, based on the forecast of the Ministry of Finance, they lead at least to the achievement of the objective set for the general government structural balance. Temporary deviation from this is permitted if exceptional circumstances as referred to in Article 3(3)(b) of the Treaty referred to in section 1 of the Act referred to in section 1 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. for 2027, (subsectors of general government) and a multiannual target path until 2028 (general government as a whole). The objectives set for the general government sub-sectors for 2027 have been expressed at a different level of precision than the objectives set for the general government as a whole. Given the differences in the level of precision, the objectives set for the sub-sectors can be considered to correspond to the objective set for the general government. Taking into account the cyclical conditions, the nominal balance target set for 2027 (−1.3% relative to GDP) would not lead to the achievement of the structural balance target (−0.5 percentage points relative to GDP). Therefore, the target-setting does not fully comply with the decree. However, the EU legislation referred to in the national legislation has been reformed. (See section 3.2).
Section 3	The General Government Fiscal Plan sets multi-annual targets for general government debt and expenditure relative to GDP at market prices. These targets are in line with the targets set for the fiscal position of the general government as a whole.	The multi-annual targets set for general government debt and expenditure relative to GDP have been expressed in the General Government Fiscal Plan in accordance with the decree (Table 1).
Section 3	The General Government Fiscal Plan presents estimates of the key revenue and expenditure items of the general government and its sub-sectors referred to in paragraph 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 estimates of the key revenue and expenditure items are presented for the general government as a whole and separately for the central government, local government, wellbeing services counties, earnings-related pension funds, and other social security funds (p. 145–149). The Government's target path differs from the forecast from 2024 onwards. The target path has been used in the stability programme (Appendix 6). The information the Plan provides on revenue and expenditure if the

	The Plan describes the impact of both options on the medium-term structural balance and long-term sustainability of the general government.	policy remains unchanged (Table 32) includes information according to the independent forecast. The relationship between the targets and the independent forecast is analysed in section 3.2, but their relationship with the unchanged policy path has not been analysed in the Plan. The Plan does not disclose all information according to the two alternatives as laid down in the decree.
Section 3	The General Government Fiscal Plan also specifies the measures required for achieving the fiscal position targets set pursuant to paragraph 2 and their estimated financial impact.	The fiscal position targets presented in the Plan do not correspond to the target path of the independent forecast of the Ministry of Finance. The Plan describes the impacts of fiscal measures on public finances, but the level of precision varies according to the measures. It does not appear from the Plan whether the measures presented by the Government in the Plan are sufficient to achieve the targets.
Section 3	The General Government Fiscal Plan presents a comparison between the most recent macroeconomic forecasts and fiscal forecasts of the Ministry of Finance and the European Commission, and if necessary, the Ministry of Finance and other independent actors, and explains any significant differences between the assumptions on which the forecasts are based.	Appendix 5 presents a comparison between the latest forecast of the Ministry of Finance and the autumn 2023 and winter 2024 forecasts of the EU Commission for six variables.
Section 3	The General Government Fiscal Plan presents the impact of various growth and interest rate assumptions on the macroeconomic forecast and the fiscal 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.
Section 3	A list of the general government units that are not part of the regular budgets at the sub-sector level shall be 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 (p. 150). The combined impact of these units on the fiscal 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.
Section 5a	When preparing its economic forecasts, the Ministry of Finance should take into consideration the National Audit Office's conclusions on the macroeconomic forecast and the fiscal forecast. If, according to the conclusions, the macroeconomic forecasts have included a bias that has had a major impact on at least four consecutive years, the Ministry of Finance shall publish the actions it has taken to correct the bias.	The fiscal policy monitoring function of the National Audit Office has not detected a bias as referred to in the Decree in the Ministry of Finance's macroeconomic forecasts.

Appendix 4: Detailed itemisation of the Government's structural policy measures

Table 1: Impacts of the Government's structural policy measures. Source: background memoranda of the Ministry of Finance, government proposals, and calculations by the fiscal policy monitoring function.

Measure	Phase: Government proposal (with number)/ estimate/calculation/decision	Impact estimate of the number of new employed people	Impact estimate – lower bound	Impact estimate – upper bound	Dynamic impact (EUR million)	Dynamic impact (EUR million) – lower bound	Dynamic impact (EUR million) – upper bound
Extension of the condition of previous employment to 12 months	Government proposal HE 73/2023 vp	5,630	5,070	6,190	148	106	179
Euroisation of the condition of previous employment	Government proposal HE 73/2023 vp	1,540	1,390	1,700	40	29	49
Restoring holiday compensation accrual	Government proposal HE 73/2023 vp	2,650	2,390	2,920	69	50	84
Extension of waiting period from five to seven days	Government proposal HE 73/2023 vp	1,230	1,110	1,350	32	23	39
Abolition of child increases	Government proposal HE 73/2023 vp	9,560	8,600	10,510	250	180	303
Abolition of earnings disregards of unemployment security	Government proposal HE 73/2023 vp	minor	-	-	-	-	-
Freezing certain social security benefits at the 2023 level	Government proposal HE 75/2023 vp	17,130	15,420	20,640	449	323	595
Child benefit increases	Government proposal HE 75/2023 vp	-	-	-	-	-	-
Social assistance standards for reasonable housing expenditure	Government proposal HE 58/2023 vp	1,000	900	1,100	26	19	32
Reduction of unemployment insurance contributions	Government proposal HE 61/2023	-	-	-	-	-	-
Amendments to the Income Tax Act	Government proposal HE 34/2023	5,260	4,740	5,790	138	99	167
Changes to general housing allowance	Government proposal HE 74/2023	not significant	-	-	-	-	-
Legislative amendments related to industrial peace	Government proposal HE 12/2024	not significant	-	-	could not be estimated	-	-
Abolition of adult education allowance	Government proposal HE 8/2024 vp	10,010	9,470	10,540	80	80	80
Abolition of job alternation leave	Government proposal HE 8/2024 vp	50	-700	800	-	-	-

Abolition of scholarship for qualified employee	Government proposal HE 8/2024 vp	not significant	-	-	-	-	-
Staggering of the level of earnings-related daily allowance	Government proposal HE 13/2024 vp	12,780	11,500	14,060	335	241	405
Termination of employment obligation*	Government proposal HE 13/2024 vp	3,470	3,120	3,810	91	65	110
Abolition of accumulation of previous employment from services*	Government proposal HE 13/2024 vp	610	550	670	16	12	19
Revocation of the protection rule for people aged 58 and over*	Government proposal HE 13/2024 vp	970	870	1,070	25	18	31
Abolition of accumulation of previous employment from pay-subsidised work	Government proposal HE 13/2024 vp	880	790	970	23	17	28
Total	**–**	**72,800**	**65,200**	**82,100**	**1,723**	**1,263**	**2,120**

Appendix 5: Example of the calculation of structural measures

This appendix illustrates the calculation of the impacts of structural policy measures on employment and public finances. These impacts can be assessed roughly by utilising elasticities. In this connection, elasticity measures the percentage change in employed people resulting from a one percent decrease in the benefit. In addition to elasticity, assumptions are needed about the change in the average gross compensation rate[26], the size of the target group of the measure, and the impact in euros of one new employed person on public finances. The gross compensation rate describes the ratio between the level of social security benefits, such as unemployment security, and a person's previous salary. For example, the employment impacts of the staggering of earnings-related unemployment security can be estimated as follows:

$$employment\ impact = \Delta grosscompensationrate * elasticity * targetgroup,$$

where $\Delta grosscompensationrate$ indicates the impact of the measure on the gross compensation rate, $flexibility$ reflects the estimated elasticity related to the measure, and $target\ group$ indicates the size of the group targeted by the measure.

The staggering of earnings-related unemployment security means that the level of the benefit falls if unemployment is prolonged. According to the Ministry of Finance, the average gross compensation rate is estimated to fall by 21.1%[27]. The elasticity estimate, 0.79, used by the Ministry of Finance is based on a study by Uusitalo and Verho (2010). In this connection, elasticity will mechanically indicate the percentage change in employed people resulting from a one-per cent reduction in the gross compensation rate. If converted to an annual level, this measure impacts technically 76,666 unemployed persons. Based on this information, the Ministry of Finance estimates that the employment impact of the staggering of earnings-related unemployment security is

$$12{,}780 = 0.211 * 0.79 * 76{,}666.$$

When calculating the bounds related to the employment impacts of the Government's structural policy measures, the fiscal policy monitoring function has only taken into consideration the elasticity-related uncertainty with regard to three uncertainties (elasticity, change in the benefit, or size of the target group).[28] The upper and lower bounds have been formed by applying 10% higher and lower elasticity values. The elasticities applied at the upper and lower bounds of the above-mentioned estimated elasticity of 0.79 are 0,71 and 0,87. The change in the benefit and the size of the target group are kept at the same level at the upper and lower bounds (see footnote 27).

The impacts on public finances resulting from the improvement in employment can be calculated by utilising the estimated number of new employed people (12,780) resulting from the measure and the impact on public finances of a new employed person (EUR 26,200). Based on these estimates, the dynamic impact of the staggering of unemployment security is estimated at EUR 335 million.

[26] Some of the measures do not impact the gross compensation rate but the participation tax rate (e.g. HE 75/2023 vp).

[27] The estimate can be found in the assessment memorandum (in Finnish) on the employment impacts of the staggering of unemployment security on the Työllisyystavoitteiden seuranta website of the Ministry of Finance.

[28] With the exception of the index freezing of social security benefits, where the values of different benefit changes have been used at the upper and lower bounds.

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