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Finlands stability programme 2013

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Abstract

The Stability Programme is based on Prime Minister Katainen's Government Programme, the Budget for 2013 approved by Parliament on 21 December 2012 and the Central Government Spending Limits Decision for 2014–2017, decided by the Government on 27 March 2013, and the forecasts on which this was based.

Finland's GDP is projected to grow by 0.4 per cent in 2013. In the medium term, GDP growth is projected to remain sluggish. The forecast for average GDP growth in 2013–2017 is only 1.4 per cent. Measured in real GDP terms, the Finnish economy will not recover to 2008 levels until 2015.

Finland's general government finances, which had long been in surplus, deteriorated sharply into deficit as a consequence of the recession in 2009, and they have remained in deficit since then. In 2012 public finances posted a deficit for the fourth year running, with the general government deficit rising to 1.9 per cent of GDP. The deficit will remain at the same level in 2013.

Population ageing will adversely affect conditions for economic growth, increase general government age-related expenditure and inevitably weaken the general government financial position. It is projected that the long-term sustainability gap in public finances is 4.2 per cent of GDP.

This Stability Programme sets a medium-term objective of -0.5 per cent of GDP for the general government structural balance. The objective is in line with both the Stability and Growth Pact and the national legislation required by the Fiscal Compact between Member States, which came into force at the beginning of 2013.

According to the forecast presented in this Stability Programme, the general government financial position will strengthen and the general government debt to GDP ratio will start to decline during the programme period. The general government structural balance will remain stronger than the medium-term objective.

Contens

Introduction and summary

Stability and convergence programmes provided under the Stability and Growth Pact form the basis for the multilateral surveillance of fiscal policy and the coordination of economic policy in the EU. The Stability Programme contains a medium-term objective (MTO) that safeguards the undershooting the 3 per cent deficit limit and long-term sustainability, an adjustment path aimed at achieving it and an estimate of debt ratio development, the economic forecasts underlying the Stability Programme, a description and assessment of the policy measures implemented to achieve the programme's targets, a sensitivity analysis, justifications where necessary for deviations from the path aimed at achieving the medium-term objective, and a multiannual budget plan.

A medium-term objective is set for the general government structural balance. The Fiscal Compact between EU Member States, which took effect from the beginning of 2013, and the national legislation required by the compact provides the legal framework for setting the objective. This Stability Programme sets a medium-term objective of -0.5 per cent of GDP for the general government structural balance. The objective is in accordance with both the Stability and Growth Pact and the national Act.

The Government has stressed the importance of measures focused on drivers of growth as a solution to the challenges facing public finances. These measures are based on the precept that Finland's economic success depends and will continue to depend on high employment, competitive production, high skills levels, equitable services and social justice as well as a universal and inclusive welfare system. In its Government Programme agreed in June 2011, the Government committed to initiate by 2015 the measures necessary to fully close the sustainability gap. The Government also aims to balance central government finances and to turn the central government debt ratio on a declining path by the end of this parliamentary term. The Government is committed to implementing additional measures if there are no indications of a fall in the central government debt-to-GDP ratio and if the central government deficit shows signs of settling above 1 per cent of GDP. In accordance with these guidelines, the Government has adopted a range of measures to strengthen central government finances during the parliamentary term.

GDP contracted by 0.2 per cent last year. Demand in the national economy was maintained by consumption, as exports declined from the previous year. The subdued outlook for the real economy and a continued sense of high uncertainty also contributed to depress investment. Despite the economy's rather disappointing performance, employment increased on an annual basis.

Finland's GDP is projected to grow by 0.4 per cent in 2013. It is anticipated that exports will start growing and that growth of exports will marginally outpace growth of imports. Historically low growth prospects and uncertainty about the future mean that private investment will decline for a second year running. Private consumption growth will be restricted by slow growth of real earnings. Inflation will remain at just over 2 per cent. Unemployment started rising after last summer, and the projected rate for the current year is 8.2 per cent.

In the medium term, GDP growth is projected to remain subdued. In 2013–2017, the average GDP growth rate is expected to be only 1.4 per cent. Measured in real GDP terms, the Finnish economy will not recover to 2008 levels until 2015.

In economic outlook risks, the emphasis is on risks to global economic development, to which Finland is sensitive due to its large export sector. Domestically, the main source of risk lies in how the real economy reacts to the international economic situation. In the longer term, the challenge is how to mount a credible economic policy response to the sustainability gap problem. Resolving that problem would reinforce faith in the future.

Finland's general government finances, which had long been in surplus, deteriorated sharply into deficit as a consequence of the recession in 2009, and they have remained in deficit since then. In 2012 public finances posted a deficit for the fourth year running, with the general government deficit rising to 1.9 per cent of GDP. In the next few years, the general government financial position will strengthen, but it is still expected to remain in deficit. The 3 per cent limit specified in the EU Treaty will not be threatened. The general government structural balance will remain stronger than the medium-term objective.

General government debt grew by EUR 10 billion last year, topping EUR 100 billion for the first time. The public debt to GDP ratio was 53.0 per cent, the highest figure recorded since 1997. General government debt relative to GDP will start to decline during the programme period. The debt ratio will not exceed the 60 per cent reference level under the EU Treaty during the programme period.

Population ageing will adversely affect conditions for economic growth, increase central government age-related expenditure and inevitably weaken the general government financial position. Age-related expenditure to GDP is projected to grow by more than 3 per cent in 2012–2030. By 2060, the figure will increase overall by 4 per cent of GDP. The funding of Finland's public finances does not rest on a stable foundation over the longer term. Growth of age-related expenditure due to population ageing threatens to put the funding of public finances onto an unsustainable path. It is projected that the long-term sustainability gap in public finances is 4.2 per cent of GDP. The sustainability gap describes the need for adjustment in public finances by the base year 2017 in order for government to be in the position to fulfil its obligations in the long term and prevent public debt from spiralling into an unsustainable position.

To strengthen central government finances, the Government has adopted a range of direct measures on reducing spending and increasing revenue, which will bolster the central government financial position by approximately EUR 5.5 billion by 2017. In addition, the Government has systematically emphasised the importance of economic growth, productivity and new jobs as the solution to the challenges facing public finances. For example, in connection with the March 2013 spending limits decision, the Government lowered the corporate income tax rate, revised the dividend tax system, launched a housing policy reform to promote the regional mobility of labour, and strengthened the social guarantee for young people as well as measures aimed at the reintegration of the long-term unemployed and people with partial work ability back into work. Furthermore, through local government reform, improved macroeconomic steering of municipalities and the restructuring of social and health care services, the Government is committed to bringing greater stability to local government finances and to enhance the productivity of public services provision.

The Government's direct adjustment measures and the current reforms to restructure the economy are aimed at maintaining confidence in the ability of Finnish government to keep its public finances on a sustainable basis. The confidence factor has become increasingly important during the current crisis in the euro area. A credible and appropriate economic and fiscal policy serves to enhance confidence and thereby to improve the economy and standard of living in the long term.

1 Economic policy objectives and premises

1.1 General

Subdued economic growth, change in the production structure and population ageing form the framework conditions for the Government's economic and fiscal policy target setting. Both central and local government are getting deeper into debt, and public finances are not on a long-term sustainable basis. Improving the conditions for economic growth and securing the funding of the welfare state are the Government's main economic and fiscal policy challenges.

The Government has stressed the importance of growth and measures focused on drivers of growth as a solution to the challenges facing public finances. These measures are based on the precept that Finland's economic success depends and will continue to depend on high employment, competitive production, high skills levels, equitable services and social justice as well as a universal and inclusive welfare system.

In its Government Programme agreed in June 2011, the Government committed to initiate by 2015 the measures necessary to fully close the sustainability gap. To close the sustainability gap, the Government aims to raise the employment rate, prolong working careers and improve the impact, effectiveness and productivity of public services and to strengthen the economy's growth potential by means of taxation and the allocation of central government expenditure. The aim is to raise the employment rate to 72 per cent and to reduce unemployment to 5 per cent by the end of this parliamentary term. The Government also aims to achieve a substantial reduction in the central government debt-to-GDP ratio by the end of this parliamentary term. The Government is committed to implementing new adjustment measures if there are signs that the central government debt-to-GDP ratio is not falling and indications that the central government deficit has settled above 1 per cent of GDP. The Government will monitor on an annual basis the fulfilment of these central government financial targets.

The Stability Programme specifies in accordance with the Stability and Growth Pact a medium-term objective (MTO) for the general government structural balance. The legal framework for setting the medium-term objective has been specified in the Fiscal Compact between EU Member States, which took effect from the beginning of 2013, and in national legislation required by the compact. [1] This Stability Programme sets a medium-term objective for the general government structural balance of -0.5 per cent of GDP, which fulfils the minimum requirements set by both the Stability and Growth Pact and the national Act.

Finland's general government finances consist of central government, local government and the social security funds, which are further divided into earnings-related pension funds, which handle statutory earnings-related pension insurance, and other social security funds. Cyclical fluctuations are reflected most clearly in the financial position of central government, particularly due to the high cyclical sensitivity of tax revenue.

1.2 Broad Economic Policy Guidelines

In 2010 the European Council decided on a new economic and employment strategy. The strategy aims to strengthen employment, productivity and social cohesion and to create for the EU a smart, sustainable and inclusive economy. The strategy sets EU-wide targets for employment, research and development expenditure, climate policy, education and reducing poverty. The current broad economic policy guidelines and employment guidelines were approved in 2010 and they are valid until 2014. Based on these headline targets, Member States set their national targets and specify hinderments to economic growth. More detailed measures to achieve the targets and to remove bottlenecks to growth are presented in the Europe 2020 national reform programmes prepared by the Member States.

Finland's Europe 2020 Strategy National Programme was submitted in April 2012. The programme set as Finland's national targets the raising of the employment rate of 20–64 year-olds to 78 per cent, maintaining R&D spending at a minimum of 4 per cent of GDP, reaching the climate and energy targets agreed in the EU, raising the proportion of 30–34 year-olds with tertiary-level education to 42 per cent, reducing the proportion of early school leavers to 8 per cent and reducing the number of people living at risk of poverty and social exclusion. Finland's national targets exceed the headline targets set in the EU.

After assessing Finland's National Programme for 2012 as well as Finland's Stability Programme Update for 2012–2015, the Council recommended for Finland in June 2012 the following measures for 2012–2013:

1) Preserve a sound fiscal position in 2012 and beyond by correcting any departure from the medium-term budgetary objective (MTO) that ensures the long-term sustainability of public finances; to this end, reinforce and rigorously implement the budgetary strategy, supported by sufficiently specified measures, for the year 2013 and beyond, including meeting the expenditure benchmark; continue to carry out annual assessments of the size of the ageing-related sustainability gap and adjust public revenue and expenditure in accordance with the long-term objectives and needs; integrate the local government sector better in the system of multi-annual fiscal framework including through measures to control expenditure;

[1] The Act on the implementation of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (EMU), the implementation of Treaty provisions of a legislative nature and as well as requirements concerning multi-annual budgetary frameworks (869/2013).

2) take further measures to achieve productivity gains and cost savings in public service provision, including structural changes and efficiency-enhancing territorial administrative reforms, also in order to respond to the challenges arising from population ageing;

3) implement the on-going measures to improve the labour market position of young people and the long-term unemployed, with a particular focus on skills development; take further steps to encourage the employment rate of older workers, including by reducing early exit pathways; take measures to increase the effective retirement age taking into account the improved life expectancy;

4) continue enhancing competition in product and service markets, especially in the retail sector, by ensuring the effective implementation of the new Competition Act and the new programme on promoting healthy competition; continue to take measures to increase the efficiency of municipal service provision, including increasing, where appropriate, the share of services subject to competitive bidding, and to ensure competition neutrality between private and public undertakings; take further steps to ensure that competition law fines have a sufficiently deterrent effect;

5) in order to strengthen productivity growth and external competitiveness, continue efforts to diversify the business structure, in particular by hastening the introduction of planned measures to broaden the innovation base while continuing to align wage and productivity developments fully respecting the role of social partners and in line with national practices.

Finland's Europe 2020 Strategy Update is being prepared simultaneously with the Stability Programme. The Stability Programme presented herein and Finland's Europe 2020 National Reform Programme are consistent with each other.

1.3 Stability Programme Update 2013 and its handling in Finland

This Stability Programme is based on the Budget approved by Parliament on 21 December 2012 and on the Central Government Spending Limits Decision for 2014–2017 and the forecasts on which this was based.

The document will be delivered to the relevant EU bodies once it has been approved by the Government in plenary session. The contents of the Stability Programme have also been presented in writing and orally to the Grand Committee of Parliament. The Commission's assessment and the Council's statement on Finland's Stability Programme will be submitted to Parliament in connection with Ecofin preparations.

Stability Programme complies with the Code of Conduct endorsed by Ecofin in September 2012.

2 Economic situation and outlook

2.1 Recent developments and short-term outlook

Before the financial crisis, the global economy became increasingly import and export intensive, with world trade growing much faster than world output. In this regard, the financial crisis brought a structural change to globalisation. In 2009–2012 the world trade growth rate was the same or even slower than output growth. In the coming years, world trade will slowly begin to pick up, reaching growth of around 5 per cent in 2015. However, this growth will mainly be driven by trade between developing countries, and therefore demand for Finnish exports will be increasingly sluggish.

US economic recovery is moving at an historically slow rate, and growth over the forecast horizon will remain below 3 per cent. US growth is constrained above all by the need to restore balances in the household sector and by the inability of the political system to reach agreement on how to tackle the country's huge federal deficit and large debt. The euro area and the EU have slipped into a mild recession, which in the latter half of 2013 will give way to slow growth. In several EU Member States, growth is hampered by poor competitiveness, the need for substantial consolidation in public finances, faltering consumer, business and banking sector confidence, and sluggish import demand from industrial countries. For example, Sweden and Germany, which are among the strongest European economies, will post growth rates of no more than 1–2 per cent over the forecast period. Growth in China is dampened by sluggish demand from industrial countries, which cannot be fully compensated by increasing demand from the domestic market and the rest of developing Asia. Nonetheless, the Chinese economy will continue to grow at around 7 per cent throughout the outlook period.

Preliminary data reveal dual tendencies in the Finland's economic performance last year. Early in the year, GDP still showed a healthy growth rate, but during the spring output moved onto a declining path and remained on that path through to the end of the year. GDP contracted by 0.2 per cent last year. Demand in the national economy was maintained by consumption: private consumption increased by 1.6 per cent and public consumption by almost 1 per cent. The export industry had a difficult year, as exports in 2012 fell by some 1½ per cent from the year before. The subdued outlook for the real economy and continued sense of high uncertainty also contributed to depress investment. Despite the economy's rather disappointing performance, employment was up 0.4 per cent in annual terms and the unemployment rate fell by one-tenth to 7.7 per cent. The employment situation began to deteriorate, however, from late 2012.

Finland's GDP is projected to grow by 0.4 per cent in 2013. The forecast reflects the expectation of a cyclical upturn, as weak economic performance late in 2012 created a negative carryover effect of –0.7 per cent. It is anticipated that exports will start growing and that growth in exports will marginally outpace growth in imports. Historically low growth prospects and uncertainty about the future mean that private investment will decline for a second year running. House building investment is predicted to fall by 3 per cent and investment in machinery and equipment by 1 per cent. Private consumption growth is restricted by slow growth of real earnings. It is predicted that wages will rise by less than 2½ per cent and that inflation will remain at just over 2 per cent. Industrial restructuring is set to continue, and partly for this reason industry will account for a declining share of GDP. Unemployment started rising after last summer, and the projected rate for the current year is 8.2 per cent.

In 2014 GDP growth will reach 1.6 per cent. Economic growth will be increasingly broadly based because, with the exception of public investment, all other demand items will have a positive growth effect. The contribution of net exports to growth will remain at the same level as in 2013, although both exports and imports will rise more quickly than the year before. Private consumption will increase by 1 per cent and the demand for consumer durables in particular will be stronger than in the previous year. Since household consumption will continue as before and the savings rate will remain negative, the household debt ratio will climb to 122 per cent. Once growth gets underway, investment will also begin to edge up slowly. House building investment will increase at a rate of 3 per cent and investment in machinery and equipment will also start rising. Despite the pick-up in economic activity, the unemployment rate will remain at 8.1 per cent. The labour market mismatch problems will persist and there are no signs of any substantial improvement in structural unemployment.

In 2015 it is projected that GDP growth will be 2.1 per cent, i.e. higher than growth in potential output growth. With both the restructuring of production and demographic change continuing, potential output growth over the near future will remain well below the long-term average.

The risks in the global economy are leaning to the downside, although they are less pronounced than earlier. In the United States, uncertainty is compounded by political tensions and antagonisms. Mandatory federal tax increases and spending cuts or 'sequestrations' have started in March following the failure of political leaders to reach agreement on an adjustment package. Under the new economic policy regime, the federal budget deficit will shrink from 7.0 per cent of GDP in 2012 to 5.3 per cent in 2013. If the tighter regime were to remain in place for the whole year, GDP growth would slow by some half of one percentage point. It is not clear when and what kind of an agreement the political parties will reach and what other elements will be included in their deal. The United States carries such considerable weight in the global economy that any changes in its activity are immediately reflected in the export demand of many other countries.

With interest rates remaining low in industrial countries, the flow of investment has turned to developing economies and safe havens where the market for housing and other assets may begin to overheat. This risk is increased by stimulus measures focused on attracting investment and credit supply to many developing countries. In Europe, the downside risks continue to remain predominant.

Domestically, the main source of risk lies in how the real economy reacts to the international economic situation. This is largely a matter of decisions taken by individual businesses, but economic policy can certainly play a part in this, too. A predictable and transparent fiscal policy coupled with a clear tax structure with strong incentive effects creates the necessary conditions for economic growth. In the longer term, the challenge is how to mount a credible economic policy response to the sustainability gap problem. Resolving that problem would reinforce faith in the future. There are some uncertainties in how to determine the size of the sustainability gap, but there is no question about its existence. It is also important not to underestimate the risks of accumulating household debt simply on the argument that the figures are around the same level as the European average. That is, many of the countries with which these comparisons are made are in serious trouble for the very reason of high household debt.

2.2 Medium-term macroeconomic scenario

The Finnish economy has still not recovered from the deep recession that started in 2008. The economy showed healthy growth in 2010–2011, but since then it has stagnated again. World trade has already recovered to the same levels seen before the financial crisis, but Finnish exports remain well below their pre-recession levels. It is predicted that GDP growth will remain sluggish. In 2013–2017, the average GDP growth rate is expected to be only 1.5 per cent. Measured in real GDP terms, the Finnish economy will not recover to 2008 levels until 2015.

Medium-term growth prospects can be viewed and considered via potential output growth. The Ministry of Finance uses the production function method jointly developed by the EU Commission and Member States to assess output growth[2]. This method examines the separate roles played by labour input, capital and total factor productivity in potential output growth.

Change in labour input can be further broken down into change in the working-age population and changes in the labour force participation rate, structural unemployment and average number of hours worked. The number of people of working age (15–74 year-olds) is expected to grow slightly over the outlook period due to net immigration[3]. Growth in the share of the population aged 65–74 will lower the labour force participation rate. For this reason, the supply of labour will remain unchanged over the medium term. It is projected that the average number of hours worked will remain unchanged, while structural unemployment will remain at around 7.2 per cent. This means that labour input will not con-

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2 For a more detailed description of the method, see The production function methodology for calculating potential growth rates and output gaps. European Economy – Economic Papers 420. July 2010

3 The working-age population is defined as the total number of people aged 15–74. Earlier calculations have used the narrower definition of people aged 15–64

tribute to potential output growth. Nonetheless it is thought that cyclical employment will improve somewhat in the medium term. It is expected that following the sharp decline seen during the recession, investment will pick up during the outlook period. At the same time, it seems that the rapid erosion of capital brought on by the recession will slow somewhat. The growth of capital stock will drive potential productivity growth over the outlook period.

The recession has eroded employment less than anticipated. Productivity growth, on the other hand, has slowed significantly during the recession. Total productivity trend growth has slowed to historically low levels in Finland. It is projected that total productivity trend growth will slowly recover to 1 per cent. Over the ten-year period before the recession in 1998–2008, total productivity trend growth averaged 1.8 per cent per year. Potential output growth is expected to accelerate over the outlook period with the rebounding of total productivity. However, the growth rate will remain very modest and average just 1 per cent in 2013–2017.

The economy's resources are still underused in the wake of the recession. The output gap, i.e. the difference between actual and potential output, is estimated to reach 2.4 per cent in 2013. In 2014–2017 it is projected that economic growth will outpace potential output growth as demand picks up and idle production resources are put to use. It is anticipated that the output gap will close in 2017.

Table 1a. Macroeconomic prospects

	2012 EUR bn	2012	2013	2014	2015	2016	2017
		change, %					
1. Real GDP	160.9	-0.2	0.4	1.6	2.1	1.7	1.6
2. Nominal GDP	194.5	2.6	2.9	3.9	4.3	4.0	3.9
Components of real GDP							
3. Private consumption expenditure	109.5	1.6	0.6	1.0	1.6	1.7	1.7
4. Government consumption expenditure	48.3	0.8	1.9	0.8	0.8	1.0	0.9
5. Gross fixed capital formation	37.8	-2.9	-2.5	2.8	3.0	1.9	1.9
6. Changes in inventories (% of GDP)	-1.2	-0.6	-0.6	-0.6	-0.3	-0.3	-0.3
7. Exports of goods and services	77.3	-1.4	0.7	3.8	4.1	5.0	5.0
8. Imports of goods and services	78.4	-3.7	0.5	3.3	3.5	4.6	4.6
Contributions to real GDP growth, % points							
9. Final domestic demand	195.6	0.5	0.3	1.3	1.6	1.6	1.6
10. Changes in inventories	-1.2	-1.7	0.0	0.1	0.2	-0.1	-0.1
11. External balance of goods and services	-1.2	1.0	0.1	0.2	0.2	0.2	0.2

Table 1b. Price developments

	2012	2013	2014	2015	2016	2017
	change, %					
1. GDP deflator	2.8	2.5	2.3	2.2	2.2	2.2
2. Private consumption deflator	2.7	2.4	2.0	1.7	2.0	2.0
3. HICP	3.2	2.7	2.4	1.8	2.0	2.0
4. Public consumption deflator	3.7	2.3	2.4	2.4	2.8	2.8
5. Investment deflator	4.6	2.9	3.0	3.3	2.2	2.2
6. Export price deflator	1.4	1.6	1.8	2.0	1.8	1.8
7. Import price deflator	3.6	1.4	1.7	2.1	2.0	2.0

Table 1c. Labour market developments

	2012 level	2012	2013	2014	2015	2016	2017
		change, %					
1. Employment, 1.000 persons	2483	0.4	-0.5	0.1	0.6	0.2	0.3
2. Employment, 1.000 hours worked	4208	-0.2	-0.5	0.5	0.8	0.2	0.3
3. Unemployment rate (%)	207	7.7	8.2	8.1	7.8	7.7	7.6
4. Labour productivity, persons	64.8	-0.6	1.0	1.4	1.4	1.4	1.4
5. Labour productivity, hours worked	38.2	0.0	0.9	1.1	1.2	1.4	1.4
6. Compensation of employees	80.8	3.2	1.9	2.8	3.2	3.2	3.3
7. Compensation per employee	32.5	2.9	2.4	2.7	2.5	3.0	3.0

Table 1d. Sectoral balances

	2012	2013	2014	2015	2016	2017
	% of GDP					
1. Net lending/borrowing vis-à-vis the rest of the world	-1.5	-1.0	-0.6	-0.4	-0.3	-0.2
of which:						
- Balance on goods and services	-0.6	-0.4	-0.2	0.0	0.1	0.2
- Balance of primary incomes and transfers	-0.9	-0.7	-0.5	-0.5	-0.5	-0.5
- Capital account	0.1	0.1	0.1	0.1	0.1	0.1
2. Net lending/borrowing of the private sector	1.0	1.5	1.2	1.0	0.9	0.9
3. Net lending/borrowing of general government	-1.9	-1.9	-1.3	-0.8	-0.7	-0.5
4. Statistical discrepancy	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6

Table 1e. Basic assumptions*

	2012	2013	2014	2015
3-month EURIBOR	0.6	0.3	0.8	1.5
Long-term interest rate (10-year government bonds)	1.9	1.9	2.1	2.4
USD/EUR exchange rate	1.3	1.3	1.2	1.2
Nominal effective exchange rate	1.3	1.3	1.2	1.2
World GDP growth (excl. The EU)	3.1	3.2	3.9	3.9
EU-27 GDP growth	-0.3	0.1	1.2	1.4
GDP growth of relevant foreign markets	-0.4	0.5	3.6	4.1
World trade growth	2.2	3.7	5.0	5.2
Oil prices, (Brent, USD/barrel)	112.0	112.0	115.0	117.0

* No specific underlying assumptions were defined for the medium-term computations.
Instead, they are based on general assessments on developments in the operating environment.

3 General government balance and debt

3.1 Fiscal policy strategy and medium-term objective

Finland's public finances have deteriorated markedly in recent years. The 2009 recession pushed the general government financial position sharply into deficit. Although the deficit is expected to decline in the next few years, the general government financial position will remain in deficit throughout the entire programme period.

Population ageing will increase general government age-related expenditure and inevitably weaken public finances. The funding of Finland's public finances does not rest on a stable foundation over the longer term. According to a revised sustainability estimate of the Ministry of Finance, the general government financial surplus ought to be 3.3 per cent of GDP in 2017 to enable the public authorities to handle their obligations also over the longer term.

In the Ecofin Council's statement (6 July 2012) on Finland's Stability Programme, Finland was urged to preserve a sound fiscal position in 2012 and beyond by correcting any departure from the medium-term objective that ensures the long-term sustainability of public finances; to this end, reinforce and rigorously implement the budgetary strategy, supported by sufficiently specified measures, for the year 2013 and beyond including meeting the expenditure benchmark; continue to carry out annual assessments of the size of the ageing-related sustainability gap and adjust public revenue and expenditure in accordance with the long-term objectives and needs; integrate the local government sector better in the system of multi-annual fiscal framework including through measures to control expenditure.

Finland's target-setting for public finances is determined by a medium-term objective (MTO) set in accordance with the EU's Stability and Growth Pact. An objective is set for the structural balance of general government finances and updated at three-year intervals. The Fiscal Compact between Member States, which came into force at the beginning of 2013, and the national legislation required by it form the legal framework for setting the objective. The act also specifies a correction mechanism that will go into effect in the event of any significant deviation from the MTO or the adjustment path leading to it.

In this Stability Programme the medium-term objective for the structural balance of general government finances is set at -0.5 per cent of GDP, which fulfils the minimum requirements set by both the Stability and Growth Pact and the national Act.

Preserving a sound and sustainable fiscal position over the long term requires that all public sector actors adopt the safeguarding of the sustainability of public finances as a guiding principle when planning their own financial management. The funding of the earnings-related pension system, which belongs to the social security fund sector, is guided by a rule according to which the funding of the system is kept on a sustainable basis by increasing the insurance contributions levied on employers and those insured as required. The funding of other social security funds is based on a pay-as-you-go system in which the system's insurance contributions and transfers from other general government subsectors are determined such that annual revenue is sufficient to cover annual expenditure. In local government finances, a structural balance of revenue and expenditure is a natural goal. Central government finances, on the other hand, are driven by the policies of the Government Programme.

The Government Programme sets as objectives the balancing of central government finances and turning the central government debt-to-GDP ratio on a declining path by the end of this parliamentary term. To achieve these targets, the Government is committed to implementing adjustment measures directed at central government revenue and expenditure as well as to reforming economic structures so that conditions for stronger-than-forecast economic growth are strengthened. The Government is also committed to implementing additional measures if there are no indications of a fall in the central government debt-to-GDP ratio and if the central government deficit shows signs of settling above 1 per cent of GDP. In addition, the Government has continued its spending limits procedure directed at central government appropriations.

Improving the structural balance of general government finances requires measures that boost general government revenue and reduce general government expenditure. The measures may be direct adjustment measures directed at revenue and expenditure or measures that improve conditions for economic growth.

In accordance with these guidelines, the Government has adopted a range of measures with direct effect to reduce central government expenditure and boost revenue. The most significant of these measures are included in the Government Programme and the spending limits decisions of October 2011, April 2012 and March 2013. The measures will be implemented gradually by 2015 and they will improve the central government's net financial position by a total of around EUR 5.5 billion by 2017.

According to the forecast presented in this Stability Programme, the general government financial position will strengthen but still remain in deficit in the programme period. Central government and general government debt relative to GDP will start to decline, however, at the end of programme period. The medium-term budgetary objective is not threatened, but the deficit target set for central government finances will not be achieved.

Structural measures boosting conditions for economic growth and the employment rate are an essential part of the package by which the Government will endeavour to improve the capacity of central government, local government and the social security funds to manage the statutory obligations prescribed for them over the longer term. Concrete decisions on a substantial reform of economic structures will reduce the need to adjust public finances through direct measures.

The Government has adopted a range of measures aimed at strengthening conditions for economic growth, productivity and employment. In connection with the April 2012 spending limits decision, the Government adopted measures directed mainly at unemployment security, the early retirement pension system, education, and growth incentives in taxation for SMEs and R&D activity. In connection with the March 2013 spending limits decision, the Government lowered the corporate income tax rate, revised the dividend tax system, launched a housing policy reform to promote the regional mobility of labour, and strengthened the social guarantee for young people as well as measures aimed at the reintegration of the long-term unemployed and people with partial work ability back into work. Furthermore, through local government reform, improved macroeconomic steering of municipalities and the restructuring of social and health care services, the Government is committed to bringing greater stability to local government finances and to enhance the productivity of public services provision.

Achievement of the growth and sustainability objectives requires sustained reforms and efforts to bolster economic growth and competitiveness, to increase employment, to extend work careers and to improve productivity in the public sector. In the labour market, the main focus must be on those groups where employment rates are lower than in other Nordic countries. Reforms designed to promote innovation, attract investment to Finland and foster competition in the marketplace would in turn support productivity growth. Local public service provision and the on-going restructuring of municipalities and services are crucial to current efforts to increase productivity in the public sector.

The Government's immediate adjustment measures and the current reforms to restructure the economy are aimed at maintaining confidence in the ability of Finnish government to keep its public finances on a sustainable basis. The confidence factor has become increasingly important during the current crisis in the euro area. A credible and appropriate economic and fiscal policy serves to enhance confidence and thereby to improve the economy and standard of living in the long term.

3.2 General government balance and debt

In 2011–2012 the general government financial position improved on the back of an improving economy, higher indirect taxes and the withdrawal of stimulus measures. Nonetheless, the financial position has remained clearly in deficit. Sluggish economic growth, population ageing and the spending pressures caused by it create challenges to the general government financial position. In 2012 the general government deficit was 1.9 per cent of GDP. Public finances were in deficit for the fourth year running. The general government financial position is also expected to remain in deficit for the next few years.

In 2012 the central government financial position deteriorated by just over one billion euros. The deficit-to-GDP ratio was 3.4 per cent. Despite adjustment measures, central government finances will remain clearly in deficit, even though the deficit will contract towards the end of the programme period. The local government financial position also deteriorated in 2012, showing a deficit of 1.1 per cent of GDP. Over the programme period, local government finances will be adversely affected, among other things, by growth in demand for social and health care services as a result of population ageing, and by cutbacks in central government transfers to local government. In the programme period, it is expected that local government finances will remain in deficit. In the coming years, the financial surplus of earnings-related pension funds will be dented by rising pension expenditure. Other social security funds are expected to remain close to balance.

The tax rate, i.e. the ratio of taxes and social insurance contributions collected by general government to total output, has been relatively stable in recent years. In 2012 the tax rate was 43.5 per cent. This year the rate will be rise due to tax hikes. The tax rate is expected to average 44.4 per cent in 2014–2017. Last year, the expenditure rate, i.e. general government spending as a proportion of GDP, was 55.7 per cent. The expenditure rate will remain at this level over the medium term. From the beginning of this year, with the introduction of the YLE tax, the Finnish Broadcasting Company (YLE) is classified as belonging to the central government sector. This change pushes up the tax rate and the expenditure rate by around 0.3 percentage points.

General government debt grew by EUR 10 billion last year, topping EUR 100 billion for the first time. The public debt-to-GDP ratio grew 4 percentage points to 53.0 per cent, the highest figure recorded since 1997. The debt ratio is expected to rise to 57½ per cent of GDP in 2015, after which the debt ratio will begin to fall. Thus the debt ratio will not exceed the 60 per cent reference level under the EU Treaty during the programme period.

If earnings-related pension funds were not included in general government in Finland, the change in public debt could be derived directly from central government and local government deficits. The fact that in Finland general government includes the earnings-related pension funds in addition to central government, local government and the social security funds has a significant impact on how the annual financial position of general government appears as a change of general government debt.

The earnings-related pension funds are in surplus. In 2012 the surplus was 2.4 per cent of GDP. Since the surplus of earnings-related pension funds is included in the primary budgetary position of general government, but is not used to pay off general government debt, this surplus must be excluded from the range of factors impacting the change in debt ratio.

Since central and local government finances will continue to remain in deficit, general government debt in nominal terms will continue to increase in the coming years. In 2017 it is estimated that general government debt will reach EUR 132 billion, i.e. EUR 30 billion more than in 2012. In the past 10 years, local government debt has increased by more than EUR 8 billion and now stands at over EUR 12 billion. The social security funds effectively have no debt.

By the end of 2012, Finnish public debt included a total of EUR 2.7 billion from loans granted by the European Financial Stability Facility (EFSF) to crisis countries. The debt figure was also increased by the Finnish contribution of EUR 1.4 billion to the capitalisation of the European Stability Mechanism (ESM).

Central government loan guarantees totalled EUR 30.6 billion at the end of 2012. Loans guarantees grew 27 per cent from the previous year. Loans guarantees were increased particularly by guarantees to the EFSF. Of the loan guarantees, 40 per cent has been granted to businesses, 26 per cent to housing associations and 18 per cent foreign countries. Finland's financial commitments and liabilities relating to the European economic and debt crisis are described in more detail on the Ministry of Finance website.

3.3 Cyclically-adjusted balance in general government finances

Targets determined with the aid of the structural balance have been set for general government finances at both the EU and the national level. The structural balance is obtained by removing from the fiscal position the impact of cyclical fluctuations in the economy as well as one-off and other temporary measures. In this Stability Programme, Finland's medium-term objective is confirmed as being a general government structural deficit of 0.5 per cent of GDP.

The impact of fiscal policy decisions on economic activity and the state of public finances can be assessed by studying annual changes in the cyclically-adjusted balance or cyclically-adjusted primary balance of general government or central government[4]. Annual changes in the cyclically-adjusted primary balance in particular shed light on whether discretionary fiscal policy is acting to stimulate or contract economic growth[5]. Central government adjustment measures are contributing to strengthening the central government cyclically-adjusted primary balance, and discretionary fiscal policy is moving towards a tighter stance in 2013–2015.

In examining changes in the cyclically-adjusted primary balance, it is important to note that population ageing and the increase in associated expenditure have begun to reduce the cyclically-adjusted primary balance not only of general government, but also of central government. This reflects the long-term effects of economic restructuring on public expenditure. For this reason, changes in the cyclically-adjusted primary balance do not as such provide an unambiguous picture of the scale of discretionary fiscal policy measures. For example, some of the adjustment measures over the next few years will go towards covering the increasing age-related expenditure. In order to strengthen the cyclically-adjusted primary balance by means of a tightening fiscal policy, it is necessary for adjustment measures each year to exceed the expenditure growth resulting from population ageing.

This year and next, the cyclically-adjusted balance of general government will improve by a total of 0.4 percentage points of GDP. This improvement is mainly due to higher central government taxes and rising pension contributions. No measures have been specified beyond 2015 that would substantially contribute to strengthening the general government financial position. Indeed, as ageing-related expenditure continues to increase, it is predicted that the cyclically-adjusted primary balance will again weaken from 2016. In 2017 the cyclically-adjusted balance is projected to be 0.5 per cent in deficit, which corresponds to Finland's medium-term objective for the structural balance.

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4 The primary balance is calculated here by deducting gross interest payments from general government net lending.

5 When examining the cyclically-adjusted balance and the primary balance as well as their changes, one should take into account uncertainty factors associated with the cyclical adjustment, which have been prominent after the sharp cyclical fluctuations caused by the deep crisis that began in 2008.

Table 2a. General government budgetary prospects

		2012	2012	2013	2014	2015	2016	2017
		EUR million	% of GDP					
Net lending by sub-sector (EDP B.9)								
1.	General government	-3 714	-1.9	-1.9	-1.3	-0.9	-0.7	-0.5
2.	Central government	-6680	-3.4	-3.1	-2.3	-1.8	-1.5	-1.1
3.	-							
4.	Local government	-2 094	-1.1	-1.0	-1.0	-1.1	-1.2	-1.2
5.	Social security funds	5060	2.6	2.1	2.1	2.1	2.0	1.8
General Government (S13)								
6.	Total revenue	104 509	53.7	54.4	54.8	54.7	54.9	54.9
7.	Total expenditure	108 223	55.7	56.3	56.1	55.6	55.5	55.4
8.	Net lending/borrowing	-3714	-1.9	-1.9	-1.3	-0.9	-0.7	-0.5
9.	Interest expenditure	3800	1.1	1.0	1.0	1.1	1.2	1.3
10.	Primary balance	-673	-0.8	-0.9	-0.3	0.2	0.5	0.8
11.	One-off and other temporary measures	0	0.0	0.0	0.0	0.0	0.0	0.0
	Selected components of revenue							
12.	Tax revenue (12=12a+12b+12c)	59 272	30.5	31.2	31.4	31.2	31.1	31.1
12a.	Taxes on production and imports	27 907	14.4	14.6	14.7	14.4	14.3	14.1
12b.	Taxes on income	30 856	15.9	16.3	16.4	16.5	16.6	16.7
12c.	Capital taxes	509	0.3	0.3	0.3	0.3	0.3	0.3
13.	Social security contributions	25 373	13.0	12.9	13.0	13.0	13.0	13.0
14.	Property income	6 809	3.5	3.5	3.7	3.9	4.0	4.1
15.	Other income (15=16-12-13-14)	13 055	6.7	6.8	6.7	6.7	6.7	6.7
16 = 6.	Total revenue	104 509	53.7	54.4	54.8	54.7	54.9	54.9
	of which: Tax burden (D2+D.5+D.61+D.91-D.995)	85 096	43.5	44.3	44.6	44.4	44.4	44.3
Selected components of expenditure								
17.	Compensation of employees + intermediate consumption	50 341	25.9	26.2	26.0	25.7	25.6	25.5
17a.	Compensation of employees	27 761	14.3	14.3	14.2	13.9	13.8	13.6
17b.	Intermediate consumption	22 580	11.6	11.9	11.9	11.8	11.9	11.9
18..	Social transfers (18=18a+18b)	41 484	21.3	21.8	21.9	21.9	22.0	22.2
	of which: Unemployment benefits	3 535	1.8	1.9	1.9	1.8	1.7	1.7
18a.	Social transfers in kind	5 426	2.8	2.9	2.9	3.0	3.0	3.1
18b.	Social transfers other than in kind	36 058	18.5	19.0	19.0	19.0	19.0	19.1
19 = 9.	Interest expenditure	3800	1.1	1.0	1.0	1.1	1.2	1.3
20.	Subsidies	2 755	1.4	1.4	1.3	1.3	1.2	1.2
21.	Gross fixed capital formation	4 257	2.6	2.6	2.6	2.5	2.4	2.3
22.	Capital transfers	611	0.3	0.3	0.3	0.3	0.3	0.3
23.	Other expenditure (23 = 24 -17-18-19-20-21)	4 975	3.0	3.0	2.9	2.8	2.8	2.7
24 = 7.	Total expenditure	108 223	55.7	56.3	56.1	55.6	55.5	55.4
	of which: Government consumption	48 274	24.8	25.2	25.0	24.7	24.7	24.6

Table 2b. No-policy change projections

	2012 EUR million	2012	2013	2014	2015	2016	2017
		% of GDP					
1. Total revenue at unchanged policies	103 944	53.3	52.7	52.5	53.7	53.7	54.4
2. Total expenditure at unchanged policies	108 243	55.7	54.1	52.1	49.9	48.0	46.2

Table 2c. Amounts to be excluded from the revenue benchmark

	2012 EUR million	2012	2013	2014	2015	2016	2017
		% of GDP					
1. Expenditure on EU programmes fully matched by EU funds revenue	1 162	0.6	0.6	0.6	0.5	0.5	0.5
2. Cyclical unemployment benefit expenditure	3 446	0.2	0.1	0.0	0.0	0.0	0.0
3. Effect of discreationary revenue measures	565	0.3	0.7	0.5	0.2	0.0	0.0
4. Revenue increases mandated by law	100	0.0	0.2	0.0	0.0	0.0	0.0

Table 3. General government debt developments

	2012	2013	2014	2015	2016	2017
	% of GDP					
1. Gross debt	53.0	56.3	57.3	57.5	57.0	56.5
2. Change in gross debt ratio	4.0	3.3	1.0	0.2	-0.5	-0.5
Contributions to changes in gross debt						
3. Primary balance	-0.8	-0.9	-0.3	0.2	0.5	0.8
4. Interest expenditure	1.1	1.0	1.0	1.1	1.2	1.3
5. Stock-flow adjustment	2.1	1.4	-0.3	-0.7	-1.1	-1.1
of which:						
- Differences between cash and accruals	0.0	0.0	0.0	0.0	0.0	0.0
- Net accumulation of financial assets	2.4	2.1	2.1	2.1	2.1	1.9
- of which: privatisation proceeds	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2
- Valuation effects (incl. GDP growth contribution)	-0.3	-0.7	-2.4	-2.8	-3.2	-2.9
p.m.Implicit interest rate on debt	3.1	2.7	2.5	2.6	2.7	3.0
Other relevant variables						
6. Liquid financial assets	99.8	-	-	-	-	-
7. Net financial debt (7=1-6)	-46.8	-	-	-	-	-
8. Debt amortization (existing central government bonds)	9.1	-	-	-	-	-
9. Percentage of debt denominated in foreign currency	0	-	-	-	-	-
10. Average maturity of central government bonds (years)	5.6	-	-	-	-	-

Table 4. Contingent liabilities

	2012	2013
	% of GDP	
Central government guarantees	17.1	-
of which: linked to the financial sector	0.5	-

Table 5. Cyclical developments

	2012	2013	2014	2015	2016	2017
	% of GDP					
1. Real GDP growth (%)	-0.2	0.4	1.6	2.1	1.7	1.6
2. Net lending of general government	-1.9	-1.9	-1.3	-0.9	-0.7	-0.5
3. Interest expenditure	1.1	1.0	1.0	1.1	1.2	1.3
4. One-off and other temporary measures	0.0	0.0	0.0	0.0	0.0	0.0
5. Potential GDP growth (%)	0.8	0.7	0.9	1.2	1.2	1.3
contributions:						
- labour	0.1	-0.1	0.0	0.1	0.0	0.0
- capital	0.5	0.4	0.4	0.5	0.5	0.6
- total factor productivity	0.2	0.3	0.5	0.6	0.7	0.7
6. Output gap	-2.1	-2.4	-1.8	-0.9	-0.4	0.0
7. Cyclical budgetary component	-1.1	-1.3	-0.9	-0.5	-0.2	0.0
8. Cyclically-adjusted balance (2-7)	-0.8	-0.7	-0.4	-0.4	-0.5	-0.5
9. Cyclically-adjusted primary balance (8+3)	0.3	0.3	0.6	0.7	0.7	0.8
10. Structural balance (8-4)	-0.8	-0.7	-0.4	-0.4	-0.5	-0.5

4 Sensitivity analysis and comparison with previous programme

4.1 Economic development risks and their impact on public finances

The baseline scenario of the Stability Programme is based, in terms of 2013–2015, on the Ministry of Finance's March 2013 economic forecast. The years 2016 and 2017 have been taken into account in the scenario based on, among other things, the growth estimate for potential output. The baseline scenario's economic projection of the general government financial position is based on, in addition to the economic forecast, the Government Programme of Prime Minister Jyrki Katainen's Government, the Spending Limits Decision for 2013–2016 approved by the Government in April 2012, the 2013 Central Government Budget, and the Spending Limits Decision for 2014–2017, approved by the Government in March 2013. According to the baseline scenario, the Finnish economy will grow by 0.4 per cent in 2013, and thereafter by just less than 2 per cent per year in the period 2014–2017.

Great uncertainties are associated with the development of the world economy, however, and Finland, due to its large export sector, is highly dependent on global economic performance. Although the euro area crisis has moderated slightly, it is not completely over. The situation in the financial markets remains sensitive and conditional on many factors. A failure to resolve the euro area crisis would undermine economic growth through many channels.

Finland's position in the global market depends on the price competitiveness of the export sector. Investment goods account for a large proportion of Finland's exports. As a result, the continuation of subdued international economic conditions is reflected more strongly in Finland's exports than in those of many other countries. In addition to the structure of foreign trade, a faster rise in labour costs than in competitor countries has promoted the weakening of the competitiveness and external balance of the Finnish economy.

Domestically, the main source of risk lies in how the real economy reacts to the international economic situation. This is largely a matter of decisions taken by individual businesses, but economic policy can certainly play a part in this, too. A predictable and transparent fiscal policy coupled with a clear tax structure with strong incentive effects creates the necessary conditions for economic growth.

Household indebtedness is already touching 120 per cent relative to the sector's disposable income. Growing indebtedness is linked above all to the development of the housing market. Stricter lending terms, widening interest rate margins on new loans and an increase in capital transfer tax will moderate the indebtedness trend. The interest rate level is still historically low, however, which will maintain households' propensity to incur debt. Despite the prolonged and fast rise in debt, the indebtedness of Finland's households still remains at the European average level. Even so, the risk of increasing household indebtedness should not be underestimated. Many countries are in serious trouble precisely due to household indebtedness.

The restructuring of production that the Finnish economy has gone through in recent years has been reflected in production-related investment, and investment in new production capacity remains modest. Machinery and equipment investments have been made mainly to replace existing capacity or to improve operational efficiency, which has resulted in the erosion of the capital stock. Investment demand will grow to some extent in 2014–2015, but still seems that capital depreciation will exceed investment, as it has done since the 2008 financial crisis. There is a risk that production-related investment will still be low at the end of the programme period, which would undermine long-term growth prospects.

The general government balance will not be corrected in the programme period through economic growth alone. Should negative risks materialise, recovery from the recession would be prolonged and public finances would be weaker than the baseline scenario at the end of the programme period. This would further increase the need to revitalise public finances and would make the releasing of pressures caused by population ageing even more difficult than at present.

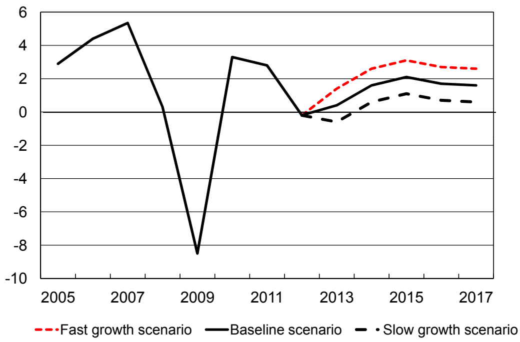
The euro area debt crisis has also increased Finland's public debt. Bilateral loans, capitalisation of the ESM, and state guarantees for the EFSF's acquisition of funds are raising the level of Finland's public debt. In addition, the State of Finland has various commitments and liabilities relating to the debt crisis that do not have a direct impact on debt. It can be considered a risk that, if various liabilities are realised, Finland's public debt might rise to 60 per cent of GDP in the medium term.

The figures below present the impact of slower-than-baseline and faster-than-baseline economic growth on the financial balance and debt in general government. The calculations are based on the assumption that annual output growth deviates by one percentage point in either direction from the baseline scenario in the period under examination.

In the slower growth scenario, total output growth would remain on average below 0.7 per cent in 2014–2017 and the unemployment rate would rise to 9 ½ per cent. The general government deficit at the end of the programme period would be 4 per cent and the debt ratio would rise to 66 per cent. This would increase significantly the need to adjust public finances.

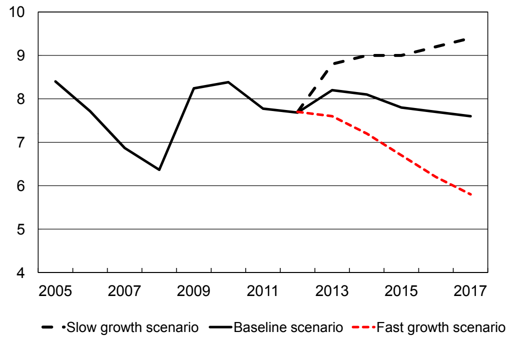
Faster growth than the baseline scenario of one percentage point would be sufficient to place the general government debt ratio on a downward path in the programme period. The general government financial position would change to a surplus. The unemployment rate would fall fairly rapidly. The materialisation of economic growth more favourable than the baseline scenario will require a significant recovery of the international economy as well as higher demand than anticipated for Finnish export products.

GDP
change in volume, per cent



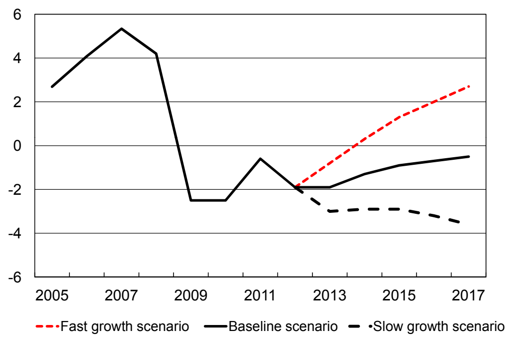
Source:Statistics Finland, MoF

Unemployment rate
per cent



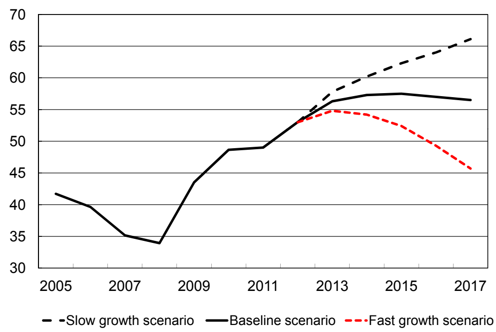
Source:Statistics Finland, MoF

General government net lending
in ratio to GDP, per cent



Source:Statistics Finland, MoF

General government gross debt
in ratio to GDP, per cent



Source:Statistics Finland, MoF

4.2 Comparison with last year's programme

The 2012 Stability Programme forecast that the Finnish economy would grow relatively slowly in 2012–2013. Contrary to expectations, however, after the beginning of 2012, economic growth weakened towards the end of the year. This was due particularly to a decline in exports. The negative growth carryover from 2012 will also dampen growth prospects for the current year. In the 2013 Stability Programme, economic growth in the next few years will be lower than forecast in 2012 programme. The medium-term outlook for economic growth has remained more or less unchanged.

The external balance is now expected to develop more weakly than in the previous programme, and the current account will remain in deficit throughout the programme period.

Contrary to the forecast in last year's programme, the economy did not grow at all in 2012. Even so, employment improved and the unemployment rate fell slightly. In the programme period, unemployment is expected to be higher than in the previous Stability Programme.

Inflation was slightly higher in 2012 than projected one year ago. In 2013 inflation is also expected to be higher than projected in the 2012 programme. Many tax base changes will contribute to a rise in consumer prices, but sluggish economic growth will have a moderating effect.

Finland's present Government began its term of office in June 2011 and agreed in its Government Programme a total of EUR 2.5 billion in central government adjustment measures by 2015. In addition, the Government agreed new adjustment measures in the 2013–2016 and 2014–2017 spending limits decisions. Overall, the adjustment measures decided by the present Government will improve central government finances by a total of 2.3 per cent of GDP at 2017 prices. After the preparation of the 2012 Stability Programme, the financial position of both central and general government has weakened compared with the 2012 programme due to weaker economic growth prospects.

General government gross debt is growing above last year's projection. In the programme period, local government debt in particular is expected to grow more than projected in the 2012 programme. Moreover, the euro area debt crisis has increased Finland's public debt more than projected one year ago. Bilateral loans, capitalisation of the ESM, and state guarantees for the EFSF's acquisition of funds have raised the level of Finland's public debt.

Table 6. Divergence from previous programme

	2012	2013	2014	2015	2016	2017
Real GDP growth (%)						
SP-2012	0.8	1.5	2.1	1.9	1.7	-
SP-2013	-0.2	0.4	1.6	2.1	1.7	1.6
Difference, %-points	-1.0	-1.1	-0.5	0.2	0.0	-
General government net lending (% of GDP)						
SP-2012	-1.1	-0.5	-0.1	0.0	0.4	-
SP-2013	-1.9	-1.9	-1.3	-0.8	-0.7	-0.5
Difference, %-points	-0.8	-1.4	-1.2	-0.8	-1.1	-
General government gross debt (% of GDP)						
SP-2012	50.7	51.8	51.9	51.6	50.9	-
SP-2013	53.0	56.3	57.3	57.5	57.0	56.5
Difference, %-points	2.3	4.5	5.4	5.9	6.1	-

SP-2012: Stability programme update 2012, April 2012
SP-2013: Stability programme 2013, April 2013

5 Sustainability of public finances

5.1 Measures to enhance sustainability

Finland's public finances have deteriorated markedly in recent years. It is anticipated that tax revenue development will continue to be weak, as economic growth remains subdued. Growth will be slowed by the dwindling number of people of working age and by the slow development of the economy's output potential. At the same time, age-related expenditure is continuing to rise with the growth of the elderly population. For this reason, public finances in Finland are on an unsustainable path in the long term.

Statistics Finland's 2012 population projection is that by 2030, the working-age population in Finland will shrink by some 100,000 people. At the same time, the number of people aged 65 or over will increase by 500,000. In 2008 the country's old-age dependency ratio, i.e. the ratio of people aged over 64 to those aged 15–64, was 25 per cent, i.e. there were four people of working age to each older person. By 2030 it is estimated that the old-age dependency ratio will increase to 44 per cent, i.e. there will be just two people of working age to each older person.

The Government has sought to improve the sustainability of public finances through immediate adjustment measures and reforms to economic structures.

To strengthen central government finances, the Government has adopted a range of measures with immediate impact on reducing spending and increasing revenue, which will bolster the central government financial position by approximately EUR 5.5 billion by 2017.

To boost conditions for economic growth, in connection with the April 2012 spending limits decision the Government adopted measures directed mainly at unemployment security, the early retirement pension system, education, and growth incentives in taxation for SMEs and R&D activity. In connection with the March 2013 spending limits decision, the Government lowered the corporate income tax rate, revised the dividend tax system and launched a housing policy reform to promote the regional mobility of labour. In addition, the Government decided to transfer funding responsibility for people unemployed for more than a year from central government to local government, which will encourage municipalities to promote employment. The Government also decided to introduce a tiered day-care fee, aimed at promoting the participation in work of mothers with small children. To reduce youth unemployment and prevent social exclusion among young people, the Government has introduced a social guarantee for young people, which guarantees work or a study place for people under 25 years of age. Furthermore, through local government reform, improved macroeconomic steering of municipalities and the restructuring of social and health care services, the Government is committed to bringing greater stability to local government finances and to enhance the productivity of public services provision. In cooperation with social partners, the Government is committed to the substantive preparation of pension reform on the basis of studies to be conducted, such that the reform comes legally into force on 1 January 2017 at the latest.

5.2 Sustainability scenario

The Ministry of Finance estimates the long-term sustainability of public finances in accordance with methods jointly agreed in the EU. In its assessment of age-related expenditure, the Ministry of Finance uses the social expenditure analysis model (SOME model), developed in the Ministry of Social Affairs and Health. The scenario's medium-term assumptions are based on a Ministry of Finance forecast.

Long-term assumptions are based on the assumptions of the EU Economic Policy Committee's 2012 Ageing Report. The population development assessment, which uses the 2012 population forecast of Statistics Finland, deviates from these assumptions. Furthermore, it is expected that the labour force participation rate will increase slightly in response to the changes to earnings-related unemployment security work and incentives for moving into work agreed under the spring 2012 working careers agreement. In the sustainability scenario, it is expected that the labour force participation rate in the population aged 15–64 will rise to 77 per cent by 2025 with the extension of work careers by around one year as people stay on longer in work and with the unemployment rate falling at the same time to 6.5 per cent. Indeed, the rise in labour participation rates and the fall in the unemployment rate will offset the decline in the number of people of working age, and it is projected that the number of people in employment will increase moderately in 2012–2060. Economic growth is expected to average 1.6 per cent in 2012–2060. The real rate of interest on public debt is assumed to be 3 per cent and the real return on investment 3.5 per cent from 2020 onwards.

The sustainability scenario takes into account growth of age-related expenditure and a decline in interest income relative to GDP in the examination period and the general government financial position in the calculation base year, 2017. Growth of age-related expenditure due to population ageing threatens to drive the funding of public finances onto an unsustainable path in the long term. The long-term sustainability gap in public finances is projected to be 4.2 per cent of GDP. The sustainability gap describes the need for adjustment in public finances by the base year 2017 in order for government to be in the position to fulfil its obligations in the long term and prevent public debt from spiralling into an unsustainable position.

Age-related expenditure to GDP is projected to grow by 3.6 per cent in 2010–2030. By 2060, the figure will increase overall by 4.3 per cent of GDP. This increase is slightly lower than the Ministry of Finance forecast one year ago, because Statistics Finland's new population projection predicts a slower increase in life expectancy than earlier. Furthermore, pension expenditure has been calculated using a revised method, which lowers the estimate for national pension expenditure growth. It is expected that pension expenditure will increase by 2.2 per cent of GDP by 2030, and then begin to fall slightly. Pension expenditure is driven by the increase in earnings-related pension costs. It is thought that the ratio of national pension expenditure to GDP will slowly edge down throughout the examination period.

The ratio of health care expenditure to GDP is expected to increase by just over 1 per cent by 2060. Health care expenditure is calculated on the assumption that spending is moving towards older age groups with advancing life expectancy. The ratio of health care expenditure to GDP is increased not only by on-going changes in the population age structure, but also by increasing earnings. The expenditure is indexed to per capita GDP growth. Rising standards of living increase expenditure by a coefficient of 1.1 for the calculation base year. By the end of the calculation period, the coefficient decreases to one. The coefficient incorporates the assumption that health care demand increases with a rising general income level and that prices outpace the general inflation rate when new and more expensive technology is put to use in health care and the wages of health care staff increase in line with national wage developments. It is assumed that public service productivity will remain at its base year level.

Expenditure profiles for long-term care in different age groups will shift with advancing life expectancy in the same way as in health care in general. Long-term care expenditure is fixed to the rise in national earnings levels because the bulk of care expenditure comes from personnel costs. Long-term care expenditure is concentrated in the population aged 80 and over, whose numbers are forecast to almost triple by 2060. Indeed, by 2060 the ratio of long-term care expenditure to GDP will increase by 2 per cent.

It is projected that education expenditure will remain highly stable over the coming decades, because no major changes are anticipated in the size of younger age groups. It is expected that unemployment expenditure will fall slightly by 2025, as the unemployment rate is expected to fall from the current figure of around 8 per cent to 6.5 per cent.

The general government financial position for the base year of the scenario is weaker than indicated in the sustainability estimate published in the spring 2012 programme. On the other hand, the estimate for age-related expenditure growth is lower than one year earlier. These changes are due to the revised population projection, revisions to the way national pensions are calculated, and to the one year shift in the base year. The estimated effect of reduced property income on the sustainability gap is also lower than one year ago.

Table 7a. Sustainability estimate in 2012 and 2013

	2012	2013
Debt servicing expenditure	0.7	0.8
Primary balance	-2.3	-0.8
Property income	2.1	1.8
Age-related expenditure	3.0	2.5
S2 sustainability gap	3.5	4.2

The sustainability calculation is effectively a scenario exercise that is based on very long-range assumptions and that therefore is subject to considerable uncertainty. Even small changes in the calculation assumptions may result in considerable differences in the sustainability estimate. If the interest rate assumptions for investments were lowered by 0.5 percentage points, the sustainability gap would widen by 0.5 percentage points. Similarly, if the assumed interest rate for central government debt were lowered by 0.5 percentage points, the sustainability gap would shrink by 0.2 percentage points. An increase of 0.25 percentage points in the assumed productivity of public services would in turn reduce the sustainability gap by 0.7 percentage points. On the other hand, an increase of 0.25 percentage points in general productivity would reduce the sustainability gap by no more than 0.3 percentage points, as increasing productivity would drive up wages and therefore the costs of public services. A 0.5 percentage point fall in the structural unemployment rate would reduce the sustainability gap by 0.15 percentage points if the lowered unemployment rate were translated into an equivalent increase in the employment rate.

Despite the uncertainties in the calculation, the estimate for the sustainability gap indicates the general direction in which public finances are heading, assuming no measures are taken to balance general government finances. If adjustment is postponed, expenditure will be driven even higher with increasing public debt and interest expenses.

Yet another reason underscoring the importance of a front-loaded approach to balancing general government revenue and expenditure in the longer term is the need to maintain intergenerational equity in the delivery of basic services to citizens.

5.3 Pension fund assets

Finland's earnings-related pension system is a partially prefunded, defined-benefit system in which the benefits are determined according to length of employment history and the level of earnings. The prefunding is collective and it does not affect the level of the pension, rather it is intended to even out the pension contributions between generations. Within the national accounting framework, the pension funds of the private sector, central government and local government are included in public social security funds.

The consolidated market value of the pension funds was EUR 149.6 billion at the end of 2012. The market value of pension fund assets declined in 2011 as the European debt crisis exerted downward pressure on share prices. The recovery of the share markets and a rise in the value of bonds as interest rates fall have boosted the market value of pension funds. Investment capital is also increased by the earnings-related pension providers' surplus, which is invested in the capital markets.

Table 7b: Long-term sustainability of public finances (2010-2060), % of GDP

	2010	2017	2020	2030	2060	2060-2010 change
	% of GDP					
Total expenditure	55,5	56,0	56,6	58,1	58,9	3,4
of which age-related and unemployment expenditure	28,0	29,5	30,0	31,6	32,3	4,3
Pensions	12,3	13,6	14,0	14,5	13,5	1,2
Earnings-related pensions	10,9	12,4	12,8	13,4	12,7	1,8
Other pensions	1,4	1,2	1,2	1,1	0,8	-0,5
Health care	5,7	5,9	6,0	6,4	7,0	1,3
Long-term care	2,2	2,4	2,6	3,2	4,3	2,1
Education	5,9	5,8	5,9	6,1	6,1	0,2
Unemployment	1,9	1,7	1,6	1,4	1,4	-0,4
Interest expenditure	1,4	1,6	3,0	4,2	12,7	11,3
Total revenue	53	54,9	55,7	55,2	54,4	1,4
of which: property income	3,7	4,2	5,0	4,5	3,7	0,0
Net lending*)	-2,8	-0,9	-2,0	-5,2	-15,3	-12,5
of which: transfer to pension funds	3,0	1,8	2,0	1,0	1,5	-1,5
Gross debt	48,6	55,9	61,4	87,1	261,7	213,1
Gross assets	124	130,0	127,6	117,1	100,6	-23,4
of which Pension funds assets	79	82,0	82,2	78,6	73,4	-5,6

*) Cyclically adjusted balance as of 2017

Source: Ministry of Social Affairs and Health, Ministry f Finance.

	Assumptions, %			
	2017	2020	2030	2060
Labour productivity growth	1,4	1,5	1,5	1,5
Real GDP growth	1,6	1,8	1,5	1,6
Participation rate				
males (20-64)	82,3	82,7	83,7	83,5
females (20-64)	77,9	78,4	79,8	79,8
total (20-64)	80,1	80,6	81,8	81,7
Unemployment rate	7,8	7,4	6,5	6,5
Population aged over 65 % of total population	21,2	22,4	25,5	28,1
Inflation	2,0	2,0	2,0	2,0
Real interest rate	3,0	3,0	3,0	3,0
Real return of pension funds, %	3,5	3,5	3,5	3,5
Net immigration, persons	17000	17000	17000	17000
Fertility	1,84	1,84	1,84	1,84

Source: Ministry of Social Affairs and Health, Statistics Finland, Ministry of Finance.

Table 8. Financial assets (market value) of the earnings-related pension institutions (sector 13141), EUR million

	2005	2006	2007	2008	2009	2010	2011
A. Non-consolidated assets							
AF21 Currency	0	0	0	13	12	12	12
AF22 Transferable deposits	530	968	1010	1100	1388	1891	2182
AF29 Other deposits	246	199	78	175	438	198	625
AF331 Short-term bills	2879	1746	4523	5076	4043	3356	6086
AF332 Long-term bonds	43084	42507	38255	38181	39824	34393	37634
AF34 Derivatives, net	48	1264	1699	664	-90	349	833
AF511 Quoted shares	21767	24773	26446	12300	21258	28263	20819
AF52 Mutual fund shares	16543	25195	32519	23436	31552	42027	40279
TOTAL	**85097**	**96652**	**104530**	**80945**	**98425**	**110489**	**108470**
% of GDP	54,1	58,3	58,1	43,6	57,1	61,8	57,2
B. Liabilities of general government (Sector 13) to pension funds							
AF331 Short-term bills	42	76	111	80	85	43	256
AF332 Long-term bonds	3844	2996	3305	3030	2541	2367	3737
TOTAL	**3886**	**3072**	**3416**	**3110**	**2626**	**2410**	**3993**
% of GDP	2,5	1,9	1,9	1,7	1,5	1,3	2,1
C. Consolidated liquid assets (=A-B))							
AF21 Currency	0	0	0	13	12	12	12
AF22 Transferable deposits	530	968	1010	1100	1388	1891	2182
AF29 Other deposits	246	199	78	175	438	198	625
AF331 Short-term bills	2837	1670	4412	4996	3958	3313	5830
AF332 Long-term bonds	39240	39511	34950	35151	37283	32026	33897
AF34 Derivatives, net	48	1264	1699	664	-90	349	833
AF511 Quoted shares	21767	24773	26446	12300	21258	28263	20819
AF52 Mutual fund shares	16543	25195	32519	23436	31552	42027	40279
TOTAL	**81211**	**93580**	**101114**	**77835**	**95799**	**108079**	**104477**
% of GDP	51,6	56,5	56,2	41,9	55,6	60,4	55,1
D. Total assts of pension funds *[*]							
Non-consolidated total assets	99991	112697	122869	103990	122987	137565	135168
% of GDP	63,5	68,0	68,3	56,0	71,4	76,9	71,3
Consolidated total assets	95360	108890	118344	99530	119336	134192	130223
% of GDP	60,6	65,7	65,8	53,6	69,3	75,1	68,7

* Derivatives, net

Source: Statistics Finland: Financial statistics.

In conjunction with a statistics reform in 2010, the State Pension Fund was transferred to the earnings-related pensions sector

6 Quality of public finances

6.1 Government policy

The Government's aim is to strengthen the financial basis for the welfare society without undermining the sustainability of public finances. In its mid-term policy review session on 28 February 2013, the Government reviewed the implementation of the Government Programme and the situation with respect to Finland's economy. The Government made policy decisions aimed at improving conditions for a higher employment rate, more intensive job creation, faster economic growth and better balance of public finances. The Government's mid-term policy review session and the government spending limits discussion on 21 March 2013 together form the mid-term review of the Government Programme.

The Government emphasises the importance of economic growth and new jobs as the solution to the challenges facing public finances. The Government will lower the corporate income tax by 4.5 percentage points to 20 per cent. The objective is to boost growth potential, accelerate investment, create jobs and consolidate businesses' salary payment capacity. The focus of taxation will shift from taxation of income to taxation of distributed profits.

The Government is committed to raising the retirement age expectancy of 25 year-olds to at least 62.4 years by 2025. In cooperation with social partners, the Government is committed to the substantive preparation of pension reform on the basis of studies to be conducted, such that the reform comes legally into force on 1 January 2017 at the latest. In addition, the Government will explore other structural measures to extend working careers and increase employment. A particular effort will be made to remove incentive traps and to make the acceptance of work more rewarding. In spring 2012, social partners proposed in the working careers agreement that the maximum amount of earnings-related unemployment allowance be limited and that incentives for moving into work be increased. Reforms relating to these issues will come into force in 2013.

A reform of the structure of local government will boost the productivity of local government finances and improve the sustainability of public finances. The goal of a reform of the social and health care service structure is a social and health care service structure based on economically robust municipalities. In the same context, the social and health care funding system will be reformed to ensure that it supports use of services according to need, prevents partial optimisation and encourage municipalities to increase cost-efficiency and effectiveness. In addition, the Government is promoting the creation of a nationwide and integrated information system for health care.

Central government productivity will be improved by an effectiveness and productivity programme. The aim of the programme is to reform central government tasks, processes, services and structures.

The Stability Programme is consistent with Finland's Europe 2020 Strategy, which is published at the same time. All of the reforms presented in the Europe 2020 Strategy are in accordance with the spending limits and have therefore been taken into account in the baseline scenario of the Stability Programme.

6.2 General government revenue and taxation

General government tax revenue decreased during the recession in 2009, but picked up again as economic growth recovered. Now growth has slowed again. The Finnish economy is suffering from a prolonged period of slow growth, which is also reflected in the development of tax revenues. A slowdown in the growth of the tax base, with business profits, private consumption, capital gains and labour income all slowing, is reflected in slower tax revenue growth.

Due to the subdued economic conditions, general government tax revenue grew slowly in 2012. Tax revenue growth was 3 per cent. Central government tax revenue growth was over 2 per cent. At the beginning of last year, a number of changes were made to tax bases that both increased and decreased tax revenue, but their net effect on tax revenue was rather limited.

Local government tax revenue also grew slowly in 2012. Local government tax revenue consists of earned income tax, a share of corporate income tax, and real-estate tax. The municipalities' corporate income tax share was temporarily increased as a stimulus measure for 2009–2011. The Government has decided to distribute to municipalities an increased share of corporate income tax revenue also in 2012–2015. The increase has been reduced to half of its previous level, however. The average municipal income tax rate rose by around 0.1 percentage points in 2012.

In 2013 economic growth will continue to remain sluggish, providing little support for an acceleration of tax revenue. The tax base changes that took effect from the beginning of the year will contribute to driving tax revenue growth. The most significant of these changes is the one percentage point increase of VAT rates across the board. The introduction of the YLE tax from the beginning of 2013 will also increase tax revenue. As part of the reform of Finnish Broadcasting Company (YLE) funding, central government expenditure will also increase, so the tax will not strengthen the general government financial position. The introduction of a bank tax at the beginning of this year will also increase tax revenue. It is estimated that discretionary tax measures will increase net tax revenue by more than EUR 1.5 billion in 2013. This year, general government tax revenue is expected to grow faster than the previous year.

A recovery of economic activity will boost tax revenue growth next year. In 2014–2017 tax revenue is projected to growth by an average 4 per cent per year.

The tax rate, i.e. the ratio of taxes and social insurance contributions collected by general government to total output, has been relatively stable in recent years. In 2012 the tax rate was 43.5 per cent. This year the rate will rise due to increased taxes. The tax rate is expected to average 44.4 per cent in 2014–2017. The introduction of the YLE tax will push up the tax rate and the expenditure rate by around 0.3 percentage points.

In recent years, Government measures aimed at increasing tax revenue have focused mainly on indirect taxes. The most significant sources of indirect tax revenue are value-added tax, the car tax and energy taxes. The most significant changes to tax bases in terms of revenue impact have been made to energy taxes and VAT. In accordance with the Government Programme, fuel taxes were increased for the first time in 2012 and will be increased again in 2014. In addition, a windfall tax will be introduced. The excise duties on alcohol, tobacco, sweets and soft drinks have also been increased and they will be increased again in 2014 and 2015.

In recent years, income tax base have been adjusted annually to ensure that tax burden on labour does not increase as a result of rising consumer prices and higher earnings. Income tax base were not adjusted, however, in 2013–2014. The corporate income tax rate was reduced to 24.5 per cent in 2012. At the beginning of 2014, business taxation will undergo a major overhaul. The corporate income tax rate will be lowered to 20 per cent and certain business subsidies and tax deductions will be discontinued. At the same time, taxation of capital income and dividends taken out of companies will be increased.

The substantial sustainability gap in general government finances will heighten pressure to increase taxation further in the programme period. The tightening of local government finances will increase pressure to implement substantial increases in municipal tax rates.

Just over half of general government property income accrues to earnings-related pension providers, the remainder to central government and municipalities. General government property income relative to GDP will start to rise next year. Earnings-related pension assets increased during 2012 by EUR 13.3 billion euros. The earnings-related pension funds' investment portfolio had a market value of EUR 149.6 billion at the end of the year. The investment portfolio of the funds may change for two reasons. The earnings-related pension funds' surplus and a rise in the price of investments increase the funds' investment portfolio. A fall in the price of investments, on the other hand, decreases the investment portfolio.

6.3 General government expenditure

The expenditure ratio, i.e. the ratio of general government expenditure to GDP, rose in 2009 to over 55 per cent, and it is also expected to remain at this higher level throughout the programme period. Last year and this year, the expenditure ratio will be increased particularly by the slow growth of the GDP value. Public expenditure (and revenue) will rise 0.3 percentage points in 2013 relative to GDP due to the introduction of the YLE tax. Finland's expenditure ratio is one the highest of the EU countries.

In the medium term, public spending is projected to grow a little more slowly than GDP, as adjustment measures directed at expenditure curb growth in spending. Population ageing will determine to a large extent the development of expenditure structure in the coming years. Only the ratios of social and health care expenditure to GDP and total spending will grow. Examined by government function (COFOG I), more than 40 per cent of general government total consolidated expenditure is directly at social expenditure, while over 10 per cent is directed at health care, education and general public services.

Interest expenditure has remained fairly moderate due to the low level of interest rates and Finland's good credit rating, even though central government debt has risen substantially four years running and local government debt has also continued to grow. Interest expenditure will inevitably grow as the level of interest rates rises, but in the medium term interest expenditure will still remain relatively low, at 1½ per cent of GDP.

Central government adjustment measures and the municipalities' tight financial situation will restrict growth of public spending in the programme period. The general government expenditure trend has been estimated on the basis of prevailing policy guidelines. Central government budget expenditure will not grow at all in real terms.

Local government finances are expected to remain tight in the next few years. The spending estimate for the municipal sector is based on the present level of obligations. The estimate includes annual volume growth of around one per cent, which corresponds to growth of demand for services arising from ageing. Nominally, local government expenditure is expected to grow at an annual rate of 3½ per cent. The pension expenditure growth rate will slow in the next few years as most of the baby boom generation will have already retired within a few years.

Table 9. General government expenditure by function

	COFOG-code	2011	2017
		% of GDP	
1. General public services	1	7.3	7.1
2. Defence	2	1.5	1.4
3. Public order and safety	3	1.5	1.5
4. Economic affairs	4	4.8	4.8
5. Environmental protection	5	0.2	0.2
6. Housing and community amenities	6	0.6	0.5
7. Health	7	7.8	8.2
8. Recreation, culture and religion	8	1.2	1.2
9. Education	9	6.4	6.4
10. Social protection	10	23.7	24.9
11. Total expenditure (=item 7=24 in Table 2)	TE	55.0	56.2

7 National fiscal procedures and institutions

The central government spending limits are the most important fiscal policy steering instrument in Finland. The Government, which took office in May 2011, made the commitment in its Government Programme to follow the spending rule it sets as well as the first spending limits decision based on it, which was issued on 5 October 2011. In the first spending limits decision of the parliamentary term, decisions were made in respect of additional expenditure and expenditure cuts for spending included within the spending limits, such that the level of spending limits expenditure will fall in real terms by EUR 1.2 billion in 2015 compared with the technical spending limits decision of March 2011.

The Government's second spending limits decision on 4 April 2012 included new substantial adjustment measures to revitalise central government finances. It was decided to make additional savings in expenditure included within the spending limits of around EUR 1.2 billion at the level of the year 2015. Due to the decided additional adjustment measures, the overall spending limits level for the parliamentary term and the annual spending limits levels were revised downwards in line with the savings. The parliamentary term spending limits level was lowered during the parliamentary term for the first time in the history of the spending limits system in its current form. Spending limits can be revised downwards, but not upwards, during the parliamentary term without this undermining the credibility of the spending limits system. The Government's third spending limits decision on 27 March 2013 included new savings, and the spending limits levels were again revised downwards accordingly.

The spending rule sets a maximum level for most, around 80 per cent, of budget expenditure. Central government budget expenditure outside the spending rule consists mainly of expenditure items that vary according to the economic cycle and automatic stabilisers, which are included, however, within the spending limits in terms of the expenditure effects of changes made to their criteria. In addition, interest payable on central government debt, value-added tax expenditure, financial investment expenditure and expenditure corresponding to technically transmitted payments, for example, also remain outside the spending limits.

In accordance with the Government Programme, if annual proceeds from the sale of shares exceed EUR 400 million, a maximum of EUR 150 million of the excess can be used for one-off infrastructure and skills investments to support sustainable growth. Proceeds accruing to central government from the auction of emissions rights can be used without reference to the spending limits for one-off expenditure on climate measures and development cooperation.

An annual provision of EUR 200 million is made in the spending limits for supplementary budgets. If the level of expenditure falls below that specified in the spending limits after supplementary budgets, the difference, to a maximum of EUR 200 million, may be used for one-off expenditure in the following year without reference to the spending limits.

If economic growth proves to be faster than forecast, the increased revenue and lower expenditure as a result of growth will be used primarily to reduce central government indebtedness. If, before 2015, central government debt as a proportion of GDP begins to fall significantly, a maximum of 30 per cent of the improved fiscal position can be used for expenditure increases in line with the Government's strategic goals.

The spending limits procedure has remained broadly the same since 2003. It has proved in practice to be a very effective system. Revenue accrued in good times has not caused permanent increases in expenditure and, moreover, in bad times the spending limits have not prevented growth of expenditure related to unemployment.

The Government Programme states that the Government will not use tax subsidies to circumvent the spending limits in any way that clashes with the purpose of the spending rule. The spending limits are neutral with regard to changes between tax subsidies and expenditure of equal magnitude. The spending limits do not restrict re-budgeting of expenditure, changes to the timing of expenditure items nor, during the parliamentary term, refunds or compensation of revenue that have proved to be unjustifiably large.

In addition to the central government spending limits, the Government Programme states that the Government is committed to implementing further adjustment measures if there are signs that the central government debt-to-GDP ratio is not falling and indications that the central government deficit has settled above 1 per cent of GDP. Adjustment measures decided by the Government directed at central government revenue and expenditure will be sufficient to reduce the central government debt ratio given the forecast of economic growth.

The basic public services programme is a key instrument in the steering of local government. In its programme, the Government stated that it confirms the long-term nature, binding effect and steering role of the basic public services programme.

The exceptionally wide responsibility of Finland's local government finances for the provision and funding of services makes local government finances a significant factor for the national economy as a whole. A provision on the basic public services programme in Section 8a of the Local Government Act that requires the preparation of measures to balance of revenue and expenditure is not currently being implemented. In addition, the weak link to the regulation and financial planning of central government finances has made the steering impact of the basic public services programme ineffectual.

Through the increased economic policy coordination of the EU, local government finances have become a more important part of national economic policy. Overall steering of public finances is being stepped up in the EU countries, and this also requires more effective macroeconomic steering of local government finances in Finland. In addition, it is necessary to amend provisions of the Local Government Act relating to the finances of individual municipalities. The central government spending limits system and the current steering of local government finances are not alone adequate to meet the challenges relating to consolidating and safeguarding the sustainability of public finances. In future, a more binding steering model will be needed as well as the strengthening of the basic public services programme procedure in both central government decision-making and in the operational and financial steering of local government. In connection with the mid-term review of the Government Programme, the Government decided to start developing the macroeconomic steering of municipalities by establishing a working group to prepare a comprehensive reform of the Local Government Act, a reform of the system of central government transfers to local government and, together with the preparation of fiscal policy statutes, jointly agreed measures to strengthen the basic public services programme procedure and develop a new spending limits review of local government finances.

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, as well as the Act on requirements relating to multi-annual budgetary frameworks came into force on 1 January 2013. Both the Treaty and the Act require an independent body to oversee compliance with the fiscal policy rules laid down in them.

The National Audit Office will act as the assessment and supervision body, operationally independent of the Member States' conduct of fiscal policy, referred to in the Treaty and the Budgetary Framework Directive. The fiscal policy auditing carried out by the National Audit Office has to date monitored the adherence to and effectiveness of the central government spending limits and the fiscal policy rule contained within them. In future, as part of the monitoring of central government finances, the National Audit Office will monitor that the Act and the national fiscal policy rules and objectives relating to public finances set by virtue of it have been adhered to.

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