MINISTRY OF FINANCE

Draft Budgetary Plan

15 October 2013

26b/2013

Economic outlook and economic policy

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Abstract

According to the Regulation (EU) No 473/2013 of the European Parliament and of the Council on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area, euro area Member States will submit their draft budgetary plans (DBPs) for the forthcoming year to the Commission by 15 October. The DBPs are a part of the new coordinated surveillance exercise that takes place in the autumn. The DBP should allow the identification of sources of possible discrepancies from the budgetary strategy in the most recent Stability Programme. The draft budgetary plan contains information on macroeconomic forecasts, budgetary targets, expenditure and revenue projections under the no-policy-change scenario, expenditure and revenue targets, discretionary measures included in the draft budget, Union's strategy for growth and jobs targets and Country Specific Recommendations, comparison between DBP and the most recent Stability Programme as well as a methodological annex. Finland's 2013 draft budgetary plan is based on the central Government's 2014 draft budget submitted to Parliament on 16 September 2013, which for the most part is founded upon the spring 2013 spending limits decision, on the 2013 supplementary budgets and on the 2014 basic public services review.

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Introduction and Summary

According to the new coordinated surveillance exercise that takes place in the autumn, Member States will submit their draft budgetary plans (DBPs) for the forthcoming year to the Commission by 15 October. The DBPs stem from the Regulation (EU) No 473/2013 of the European Parliament and of the Council on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area, which is part of the new Stability and Growth Pact (SGP) legislation (one of the two-pack regulations). The goal is to ensure that the recommendations of the Council and of the Commission are taken into account in Member States' budgetary procedures and to facilitate policy coordination in the euro area. The DBP should allow the identification of sources of possible discrepancies from the budgetary strategy in the most recent Stability Programme.

The Commission will issue an opinion on the Member State's DBP before the adoption of the corresponding national budget. Where, in exceptional cases, the Commission identifies particularly serious non-compliance of a plan with the budgetary policy obligations laid down in the SGP, a revised draft plan will be requested after consulting the Member State concerned. The Commission opinions will be published and presented to the Eurogroup, which will have a discussion on them as well as on the Commission opinion on the budgetary situation and outlook in the euro area as a whole.

The draft budgetary plan contains information on macroeconomic forecasts, budgetary targets, expenditure and revenue projections under the no-policy-change scenario, expenditure and revenue targets, discretionary measures included in the draft budget, Union's strategy for growth and jobs targets and Country Specific Recommendations, comparison between DBP and the most recent Stability Programme as well as a methodological annex. The DBP updates the standard tables in the Stability Programme and supplements them with detailed information about the measures presented in the draft budgetary plan.

Finland's 2014 draft budgetary plan is based on the central Government's 2014 draft budget submitted to Parliament on 16 September 2013, which for the most part is founded upon the spring 2013 spending limits decision, on the 2013 supplementary budgets and on the 2014 basic public services review. The major decisions were taken in the spring and presented in the 2013 Stability Programme. In the context of the 2014 draft budget, the Government agreed on a Structural Policy Programme to strengthen conditions for economic growth and to bridge the sustainability gap in general government finances[1]. The Government is prepared to take decisions on a concrete programme and a timetable by the end of

[1] English version of the Structural Policy Programme is available at: http://valtioneuvosto.fi/tiedostot/julkinen/budjetti/290813/Structural-policy-programme.pdf

November. At the same time, the Government will assess, whether the proposed measures combined are sufficient to bridge the sustainability gap, and will at the same time take into account the timetable and contentual goals for the reform of the pension system. The Government will take the possibly required additional measures to bridge the sustainability gap in the context of the spending limits decision in spring 2014. The content and implementation of the Structural Policy Programme as well as the additional consolidation measures possibly taken in the 2014 spending limits decision to turn the the central government debt to GDP ratio on a declining path will be reported in the 2014 Stability and Europe 2020 Programmes in the context of the European Semester.

Public finances in Finland

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.

Central government's 2014 budget and the spending limits

In 2012–13 GDP will contract, which will be directly reflected in the central government finances. However, because of the consolidation measures decided by the Government, the central government deficit will not worse this year. The deficit is estimated at 7.3 bn. Euros this year, which is 3.8% of GDP.

Next year, central government finances will improve faster, as economic growth recovers. Expenditure growth slows down substantially, while revenues continue to increase. In the medium term, the deficit continues to slowly improve annually and in 2017 the deficit is estimated at 2.1% of GDP.

The Government is committed to a responsible long-term expenditure policy through central government spending limits system and expenditure ceiling that covers approximately 80% of on-budget expenditure. The spending limits contribute to a stable and credible management of central government finances.

The 2014 budget proposal is based on the April 2013 spending limits decision for 2014–2017. The spending limits take account of the expenditure savings adopted in the Government Programme and in connection with the spring 2012 and spring 2013 spending limits decisions.

The 2014 spending limits level is set at EUR 42,796 million, of which some EUR 83 million is set aside as an unallocated reserve after the 2014 budget proposal. A further EUR 200 million is reserved for supplementary budget needs. Items excluded from the spending limits include expenditure that fluctuates with economic cycles as well as automatic fiscal stabilisers, such as unemployment security expenditure, pay guarantee, housing allowances, and the central government contribution to the cost of basic social assistance. These expenditures are however included in the spending limits to the extent that changes to the definition of these items affect expenditures. Also excluded from the spending limits are interest payments on central government debt, VAT expenditure, financial investment expenditure and expenditure corresponding to technically transmitted payments and external funding contributions. Total expenditure outside the spending limits in 2014 comes to around EUR 11.4 billion.

The 2014 budget proposal puts central government expenditure at around EUR 53.9 billion, down by approx. EUR 0.6 billion from the 2013 original budget. The savings agreed by the Government increase in 2014 by a net total of over EUR 0.6 billion compared to savings of year 2013. Another factor contributing to lower appropriations compared to 2013 is the transfer of export refinancing functions to the export credit agency Finnvera. On the other hand, central government expenditure will be increased due to additional resources e.g. to social guarantee scheme for young people and young adults' skills programme, to student welfare services, the development of services for the elderly, investment in LNG terminals and the capitalisation of a new growth fund, as well as certain automatic factors, such as statutory and contractual indexations and the growth of central government pension expenditure. Interest outlays on central government debt total around EUR 1.8 billion, roughly the same as in the current year.

In 2014 it is estimated that on-budget revenue (excluding borrowing) will reach EUR 47.2 billion and tax revenue EUR 40.1 billion. On-budget revenue will increase by nearly 3% compared to the amount budgeted for 2013 (including supplementary budget proposals). The growth of tax bases will be constrained by the decline in total output in 2013 and modest economic growth in 2014. Proposals are in place to increase several excise duties with a view to strengthening central government's budgetary position. In terms of scale, however, the single most significant tax policy decision concerns the reform of corporate and dividend income taxes.

The budget proposal for 2014 shows a deficit of EUR 6.7 billion, which will be covered by increased government debt. At year-end 2014 it is estimated that government debt will be around EUR 100 billion.

The on-budget deficit will increase by some EUR 1.8 billion compared to the spring 2013 spending limits decision. The single biggest factor in this change is the deterioration of the economic outlook compared to the forecast of spring 2013, which above all is reflected in lower estimates for central government tax revenue.

Local government

The financial equilibrium of local government tasks and obligations are examined in the Basic public services programme and the related annual Basic public services budget. Basic public services budget is part of general strategy and outlook of the central government budget proposal. The impact of the central budget proposal on local government expenditures and revenues is estimated in the Basic public services budget. The Basic public services budget covers basic services mandated by law, economic outlook for local government finances, and different projections on local government finances in municipalities of various size and in different parts of the country.

In 2013 it is projected that local government tax revenue growth will be faster than last year, which is explained by one-off timing factors. The growth of central government transfers to local governments, on the other hand, will slow to 2½% as a result of the adjustments made to central government finances. Local government finances will remain firmly in deficit in 2013. It is estimated that the deficit will be close to 1% of GDP, and local government debt will continue to increase.

In 2014 it is predicted that local government tax revenue will increase by 3%. Wage and salary income growth, a major source of local government tax revenue, is estimated to come in close to 2½%, while pension income is expected to reach 4½%. The transfers from the central government budget received by the local governments will stay approximately at the 2013 level. The local government consumption increases because of the growth of the demand for social and health services.

Social security funds

Earnings-related pension funds are part of the general public finances. In 2013 the surplus of earnings-related pension funds will shrink to 2.1% of GDP due to the slowdown of wage bill growth and to the postponement of increases to pension contributions.

In 2014 the revenue of earnings-related pension funds will be increased by higher pension contribution rates, accelerating wage bill growth and increasing interest revenue. Expenditure growth will be limited by lower indexations than last year. The surplus in the earnings-related pension funds is expected to remain at the previous year's level in 2014.

Other social security funds comprise mainly the Social Insurance Institution (SII) and the Unemployment Insurance Fund, which are responsible for the provision of basic security and for earnings-related unemployment security, respectively. The SII's cost expenditure is covered from the State Budget, social insurance contributions and to a minor extent from local government budgets. Earnings-related unemployment insurance is funded from unemployment insurance contributions collected from employers and wage earners as well as from central government transfers.

It is assumed that other social security funds will remain close to balance throughout the outlook period. The growth of expenditure in 2013 and 2014 will be compensated through increased central and local government funding.

1. Macroeconomic forecasts[1]

Table 0.i) Basic assumptions

	2012	2013	2014
3-month Euribor	0.6	0.2	0.3
Long-term interest rate (10-year government bonds)	1.9	1.8	2.3
USD/€ exchange rate	1.3	1.3	1.3
Nominal effective exchange rate	-2.7	1.9	0.0
World GDP growth (excl. The EU)	3.0	3.1	3.8
EU-27 GDP growth	-0.3	-0.1	1.4
Growth of relevant foreign markets	-0.5	0.4	3.5
World trade growth	1.9	3.0	5.0
Oil prices. (Brent. USD/barrel)	112	106	109

Table 1a. Macroeconomic prospects

	2012 level	2012	2013	2014
			change, %	
1. Real GDP	159.9	-0.8	-0.5	1.2
Of which				
1.1. Attributable to the estimated impact of aggregated budgetary measures on				
2. Potential GDP	163.2	0.6	0.4	0.6
contributions:				
- labour				
- capital				
- total factor productivity				
3. Nominal GDP	192.5	2.0	1.5	3.3
Components of real GDP				
4. Private final consumption expenditure	108.5	0.2	0.0	0.8
5. Government final consumption	48.3	0.6	1.2	0.8
6. Gross fixed capital formation	37.7	-1.0	-4.0	-0.8
7. Changes in inventories and net acquisition of valuables (% of GDP)	0.4	0.2	0.1	0.5
8. Exports of goods and services	78.1	-0.2	-0.5	3.7
9. Imports of goods and services	79.8	-1.0	-0.7	3.0
Contributions to real GDP growth, % points				
10. Final domestic demand	194.6	0.1	-0.5	0.5
11. Changes in inventories and net acquisition of valuables	0.4	-1.3	-0.1	0.3
12. External balance of goods and services	-1.6	0.4	0.1	0.3

[1] The forecast presented in the draft budgetary plan, which was also used as the basis for the central government's budget proposal, has been prepared in the Economics Department of the Ministry of Finance. The forecast is independent and the regulatory and other changes that formally guarantee its independence are currently being prepared. The draft budgetary plan is based on the data availa-ble on 29 August 2013.

Table 1b. Price developments

	2012	2013	2014
	change, %		
1. GDP deflator	2.9	2.0	2.1
2. Private consumption deflator	2.9	1.8	2.0
3. HICP	3.2	2.3	2.2
4. Public consumption deflator	4.0	2.3	2.1
5. Investment deflator	4.1	2.0	2.3
6. Export price deflator	1.2	0.1	0.7
7. Import price deflator	2.4	0.1	0.9

Table 1c. Labour market developments

	2012 level	2012	2013	2014
		change, %		
1. Employment, 1 000 persons	2 483	0.4	-0.7	0.1
2. Employment, 1 000 000 hours worked	4 232	0.1	-0.8	0.5
3. Unemployment rate (%)	207	7.7	8.3	8.2
4. Labour productivity, persons	64.4	-1.2	0.2	1.1
5. Labour productivity, hours worked	37.8	-1.0	0.3	0.6
6. Compensation of employees	80.9	3.2	1.4	2.4
7. Compensation per employee	32.6	2.8	2.2	2.3

Table 1d. Sectoral balances

	2012	2013	2014
	% of GDP		
1. Net lending/borrowing vis-à-vis the rest of the world	-1.7	-1.5	-1.2
of which:	0.0	0.0	0.0
- Balance on goods and services	-0.9	-0.8	-0.6
- Balance of primary incomes and transfers	-1.0	-0.8	-0.7
- Capital account	0.1	0.1	0.1
2. Net lending/borrowing of the private sector	0.9	1.2	0.9
3. Net lending/borrowing of general government	-1.9	-1.9	-1.3
4. Statistical discrepancy	-0.7	-0.7	-0.7

2. Budgetary Targets

Table 2a. General government budgetary targets broken down by subsector

Net lending (+) / net borrowing (-) by sub-sector	2013	2014
	% of GDP	
1. General government	-2.2	-1.9
2. Central government	-3.4	-2.9
3. -	-	-
4. Local government	-0.9	-1.1
5. Social security funds	2.0	2.1
6. Interest expenditure	1.0	1.0
7. Primary balance	-1.2	-0.9
8. One-off and other temporary measures	0.0	0.0
9. Real GDP growth (%)	-0.5	1.2
10. Potential GDP growth (%)	0.4	0.6
contributions:		
- labour		
- capital		
- total factor productivity		
11. Output gap	-2.9	-2.3
12. Cyclical budgetary component	-1.5	-1.2
13. Cyclically-adjusted balance	-0.7	-0.7
14. Cyclically-adjusted primary balance	0.3	0.3
15. Structural balance	-0.7	-0.7

Table 2b. General Government debt developments

	2013	2014
	% of GDP	
1. Gross debt	58.3	60.7
2. Change in gross debt ratio	4.8	2.4
Contributions to changes in gross debt		
3. Primary balance	-1.2	-0.9
4. Interest expenditure	1.0	1.0
5. Stock-flow adjustment	2.5	0.5
of which:		
- Differences between cash and accruals		
- Net accumulation of financial assets3		
of which:		
- privatisation proceeds		
- Valuation effects and other		
p.m.: Implicit interest rate on debt	2.6	2.5
Other relevant variables		
6. Liquid financial assets		
7. Net financial debt		
8. Debt amortization (existing bonds) since the end of the previous year		
9. Percentage of debt denominated in foreign currency		
10. Average maturity		

Table 2c. Contingent liabilities

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

3. Expenditure and Revenue Projections under the no-policy change scenario

Table 3. General government expenditure and revenue projections at unchanged policies broken down by main components

General government	2013	2014
	% of GDP	
1. Total revenue at unchanged policies	54.5	55.5
Of which		
1.1. Taxes on production and imports	14.3	14.6
1.2. Current taxes on income, wealth, etc	16.1	16.6
1.3. Capital taxes	0.3	0.3
1.4. Social contributions	13.2	13.1
1.5. Property income	3.7	3.8
1.6. Other	7.0	6.9
p.m.: Tax burden	44.1	45.0
2. Total expenditure at unchanged policies	57.9	58.0
Of which		
2.1. Compensation of employees	14.7	14.5
2.2. Intermediate consumption	12.2	12.2
2.3. Social payments	22.6	22.9
of which Unemployment benefits	2.1	2.1
2.4. Interest expenditure	1.0	1.0
2.5. Subsidies	1.4	1.4
2.6. Gross fixed capital formation	2.6	2.6
2.7. Capital transfers	0.3	0.3
2.8. Other	3.1	3.0

4. Expenditure and Revenue targets

Table 4a. General government expenditure and revenue targets, broken down by main components

General government	2013	2014
	% of GDP	
1. Total revenue target	55.5	55.8
Of which		
1.1. Taxes on production and imports	14.9	14.9
1.2. Current taxes on income, wealth, etc	16.5	16.3
1.3. Capital taxes	0.3	0.3
1.4. Social contributions	13.2	13.4
1.5. Property income	3.7	3.8
1.6. Other	7.0	6.9
p.m.: Tax burden	45.1	45.2
2. Total expenditure target	57.7	57.7
Of which		
2.1. Compensation of employees	14.7	14.5
2.2. Intermediate consumption	12.1	12.1
2.3. Social payments	22.5	22.7
of which Unemployment benefits	2.1	2.1
2.4. Interest expenditure	1.0	1.0
2.5. Subsidies	1.4	1.4
2.6. Gross fixed capital formation	2.6	2.6
2.7. Capital transfers	0.3	0.3
2.8. Other	3.1	3.0

Table 4b. Amounts to be excluded from the expenditure benchmark

	2012 EUR million	2012	2013	2014
		% of GDP		
1. Expenditure on EU programmes fully matched by EU funds revenue	1 206	0,6	0,6	0,5
2. Cyclical unemployment benefit expenditure	3 448	0,2	0,3	0,1
3. Effect of discreationary revenue measures	589	0,3	0,7	0,3
4. Revenue increases mandated by law	100	0,0	0,2	0,0

5. Description of discretionary measures included in the draft budget

Table 5a. Discretionary measures taken by General Government

List of measures	Detailed description	Target	Accounting principle	Adoption in status	Budgetary impact			
					2013	2014	2015	2016
					of GDP %			
Personal income tax	Personal income tax		accrual	partly decided**	0.4	0.1	-0.1	-0.1
Corporate income tax	Corporate income tax		accrual	partly decided**	0.0	-0.4	0.1	0.0
Indirect taxes	Indirect taxes		accrual	partly decided**	0.6	0.3	0.1	0.0
Contributions	Contributions		accrual	proposal***	0.0	0.3	0.3	0.1
Expenditure measures, total	Expenditure measures, total		accrual, cash-based	partly decided**	-0.2	-0.3	-0.6	0.0

* Many of the discretionary measures do not pass a size criterion (at least 0,05% of the GDP). Therefore the measures are combined and merely the aggregate effect of measures is reported. Some of the measures are temporary but most of them are permanent.

**Parliament will confirm during fall 2013

***Ministry of Social Affairs and Health will confirm during fall 2013

Table 5b. Discretionary measures taken by Central Government

List of measures	Detailed description	Target	Accounting principle	Adoption in status	Budgetary impact			
					2013	2014	2015	2016
					of GDP %			
Personal income tax	Personal income tax		accrual	partly decided**	0.3	0.1	0.0	-0.1
Corporate income tax	Corporate income tax		accrual	partly decided**	0.0	-0.4	0.1	0.1
Indirect taxes	Indirect taxes		accrual	partly decided**	0.6	0.3	0.1	0.0
Expenditure measures, total	Expenditure measures, total		accrual, cash-based	partly decided**	-0.2	-0.3	-0.6	0.0

* Many of the discretionary measures do not pass a size criterion (at least 0,05% of the GDP). Therefore the measures are combined and merely the aggregate effect of measures is reported. Some of the measures are temporary but most of them are permanent.

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6 Indications on how the measures in the DBP address CSR and the targets set by the Union's Strategy for growth and jobs.

The content and implementation of the Structural Policy Programme will be reported in the 2014 Stability and Europe 2020 Programmes in the context of the European Semester.

6a CSR recommendations

No significant changes since spring 2013, see:

http://ec.europa.eu/europe2020/pdf/nd/annex22013_finland_en.pdf

6b Targets set by the Union's Strategy for growth and jobs

No significant changes since spring 2013, see:

http://ec.europa.eu/europe2020/pdf/nd/annex32013_finland_en.pdf

7. Divergence from latest SP

Table 7. Divergence from latest SP

	2012	2013	2014
	% of GDP		
Target general government net lending/net borrowing			
Stability Programme	-1.9	-1.9	-1.3
Draft Budgetary Plan	-1.8	-2.2	-1.9
Difference *	0.1	-0.3	-0.7
General government net lending projection at unchanged policies			
Stability Programme	-2.4	-1.4	0.4
Draft Budgetary Plan	-2.1	-3.4	-2.5
Difference *	0.3	-2.0	-3.0

* The difference is explained by the lower GDP level (over 6 bn. euros at the level of2014) and the method change in the calculation of total expenditure in a no-policy scenario.

Annex: Methodological aspects

The macro forecast is based on expert views, Ministry of Finance DSGE model (see e.g. Economic Survey, autumn 2013, p. 15, and Economic Survey, spring 2013, p. 19), a short-term factory model and various partial models.

The public finance forecast is based on among other things the short-term macro forecast as well as medium-term calculations, budget proposals, spending limit decisions, tax base forecasts and discretionary tax measures and detailed tax revenue estimates derived from them, the basic public service programme and decisions on social security contributions and benefits.

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