Fiscal policy monitoring report 2021

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FULL REPORT (FI) FULL REPORT (EN)

What we assessed and why

We oversee and assess fiscal policy in our role as an independent national fiscal policy monitoring body (as referred to in the EU's Fiscal Compact and in EU law). Monitoring involves assessing the way in which the rules and the binding objectives that steer fiscal policy are set and implemented. This extends to covering the monitoring of compliance with the Medium-Term Objective (MTO) set for general government finances and the related correction mechanism, monitoring of the preparation and implementation of the General Government Fiscal Plan, and monitoring of compliance with the EU Stability and Growth Pact.

For the fiscal policy monitoring report 2021, our assessment included the fiscal policy stance, the trend in the government debt-to-GDP ratio, the business cycle, the situation with regard to fiscal policy steering instruments, the planning of general government finances during the COVID-19 pandemic, and the measures adopted by the Government to boost employment. We also examined the outlook on EU fiscal policy rules and how realistic the Ministry of Finance's (MoF) economic forecast is.

What we found

In our view, the Government's fiscal policy was sufficient to stimulate the economy in 2020, when the effects of COVID-19 first materialised. Public expenditure helped support the economy during the recession and smooth out cyclical fluctuations. In 2021, the economy seemed to grow robustly, and the framework for fiscal policy was more flexible. It is, therefore, possible that the fiscal impulse for the whole of 2021 may excessively intensify the business cycle. It was important to ensure that the economy would recover after the crisis, and so pro-cyclical stimulus measures were justified in 2021. According to this ex-ante assessment, the fiscal impulse for 2022 will be contractionary and counter-cyclical. The objectives set for public finances in the General Government Fiscal Plan of spring 2021 were broad, but met the legal requirements.

Central government spending limits increased substantially during the parliamentary term. This was made possible by the decision to end the spending limits in 2020, and by the exceptions and increases made to the spending limits as from 2021. Most of these changes related to the COVID-19 pandemic.

Decisions taken in spring 2021 to raise the spending limits in 2022 and 2023 clearly violated the principles of the spending-limits system. However, it is important that the spending-limits system should continue to serve as a credible tool for the long-term planning of central government expenditure.

Public finances are recovering from the slump caused by the COVID-19 crisis slightly faster than previously anticipated. The government debt-to-GDP ratio has risen considerably in Finland during the pandemic, though it is a moderate rise compared to other EU countries.

The sustainability roadmap that the Government introduced in 2020 provides a starting point for stabilising general government finances and improving sustainability in the long term. However, the measures to boost employment that were taken during the parliamentary term have only a modest strengthening impact on public finances compared to the objective of €1 billion to €2 billion referred to in the roadmap. In terms of fiscal impacts, the most significant structural employment measure taken by the Government so far is the decision to withdraw the right to additional days of unemployment benefit. The budget proposal for 2022 includes few employment measures with short-term impacts.

What we concluded

Like other fiscal institutions in the EU, we deem it important to have clear and carefully drafted rules that support debt sustainability. Borrowing by Finland on the scale seen in 2020 and 2021 has effectively been at zero interest, which will aid public finances in the next few years. The risk, however, is that interest expenses may rise in the future. For that reason, it is important to ensure a flattening of the curve of the debt-to-GDP ratio, which is an objective included in the Government's sustainability roadmap.

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

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

Both national and EU legislation focus on strengthening public finances when the exceptional circumstances cease to exist. In its fiscal planning for 2023, the Government should consider a rule-based need, so that any new tax and expenditure decisions for 2023 are in line with the need to strengthen finances in net terms. The current decisions are likely to strengthen public finances in line with fiscal regulation.

The MoF forecast, on which the state budget is based, is largely in line with other expert forecasts, particularly for 2022. Overall, we also deem it realistic.

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