MINISTRY OF FINANCE

Economic Survey

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Economic outlook and economic policy

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PO Box 28 (Snellmaninkatu 1 A) FI-00023 GOVERNMENT
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Abstract

Economic growth in the United States is forecast to come in at almost 3% this year and next, and to accelerate even further in 2016. Growth in China will remain at around 7%, and the Japanese economy also looks set to recover to a steady growth rate of 1½%. After two years of negative growth it is expected that the euro area will rebound to growth of around 1%, and the growth forecast for the next couple of years is 1½%.

In 2014 Finnish GDP is expected to show zero growth. The forecast includes a very moderate economic upturn, with this year's internal growth moving into positive territory. Net exports will have a definite positive impact on economic growth, and they are the most significant growth-driving factor this year. Private consumption will show no growth from last year, and private investment will fall by 4.6% mainly as a result of sluggish investment in residential construction and investment in machinery and equipment. The situation in the labour market will continue to deteriorate. The unemployment rate is expected to edge up to 8.6%, and employment will fall by 0.4% from the previous year. Inflation will come in at 1.1%, with changes to indirect taxation accounting for around half a percentage point this year and next.

In 2015 growth will pick up to 1.2% and become more broadly based. Private consumption will increase somewhat, by 0.3%. Exports growth will be slower than world trade growth, and therefore the loss of market shares will continue. The situation in the labour market will continue to remain weak. Unemployment will edge down to 8.5% from the year before and employment will increase by close to half a per cent. Labour market mismatch problems remain significant, and the level of structural unemployment is high. It is forecast that inflation will remain at around 1½%.

In 2016 economic growth is predicted to come in at 1.4%. This growth will increasingly be driven by domestic demand. The contribution of net exports will also remain positive, although it is thought that Finnish exports will continue to grow more slowly than world trade.

Persistent cyclical weakness has resulted in a long-standing deficit in public finances, although the government's adjustment efforts have helped to curb the growth of the deficit. The general government budgetary position is exacerbated by increasing expenditure associated with population ageing. The general government sector that is affected most by cyclical fluctuations is central government, particularly because of the high cyclical sensitivity of tax revenue. Central government is in deep deficit. However over the outlook period the deficit will shrink in response to adjustment efforts and rebounding economic growth.

Preface

The autumn 2014 Economic Survey is an offprint of the annex to the Government's 2015 budget proposal. The survey offers projections of the economic outlook in 2014–2016. In addition to short-term prospects, the Economic Survey includes medium-term projections extending to 2018.

The forecast and trend projections in this Survey have been prepared independently by the Ministry of Finance Economics Department, without any outside input, based on the latest data available. The forecasts in the Survey are based on provisional national accounts data for 2013 published in July 2014 by Statistics Finland and on other public statistical sources available before 8 August 2014. The Survey does not include policy measures after 8 August 2014, excluding the Government's budget proposal for 2015.

The Economic Survey has been published since 1948.

Helsinki September 2014

Ministry of Finance
Economics Department

Markus Sovala
Director general

Mika Kuismanen
Director
Forecasting unit

Mikko Spolander
Director
Stability unit
(Public finances)

The source for all data on materialised developments is Statistics Finland unless otherwise indicated.

SYMBOLS AND CONVENTIONS USED

-	nil
0	less than half the final digit shown
..	not available
.	not pertinent
*	provisional
**	forecast
CPB	CPB Netherlands Bureau for Economic Policy Analysis
HWWI	Hamburgisches WeltWirtschafts Institut
IMF	International Monetary Fund
MoF	Ministry of Finance

Each of the figures presented in the tables has been rounded separately.

Contents

Summary

Economic outlook 2014-2016

The Economics Department's outlook for 2014–2016 is based on the new ESA 2010 accounting standards and statistics. Revised national accounts figures for 1975 and onwards, released in July, put the value of GDP on average 4% and the volume of GDP on average 2.3% higher than previously estimated. However the cyclical outlook remains unchanged. The new ESA 2010 accounting system has a broader concept of assets, for instance, and now includes R&D expenditure, and it also provides clearer guidance for the treatment of global production methods. The statistical reform has brought changes to a number of GDP related indicators.

The recent economic debate has been dominated by the Ukraine crisis and the subsequent imposition of economic sanctions. However it is important to bear in mind that Russian economic growth was slowing even before this current crisis. Neither the EU sanctions nor the Russian counter-sanctions have significant macro effects on the Finnish economy. Their indirect effects, however, may have significant implications if the crisis persists.

The Economics Department had already downgraded its outlook for the Russian economy in its March forecast, before the escalation of the Ukraine crisis. In the June forecast, following the deepening of the crisis and the slowdown of economic growth in Russia, the tone of the outlook was even more cautious. The current outlook takes account of the events of July and August, which have further dimmed the prospects.

Elsewhere in the global economy, there are some signs of rebounding growth. In the United States it is predicted that economic growth will come in at almost 3% this year and next, and accelerate even further in 2016. Growth in China will remain at around 7%, and the Japanese economy also looks set to recover to a steady growth rate of 1½%. After two years of negative growth it is expected that the euro area will rebound to growth of around 1%, and the growth forecast for the next couple of years is 1½%. However especially in the euro area the situation remains fragile and susceptible to negative shocks. In Europe this has to do not so much with the situation in Russia, but rather with the euro area's success or otherwise in resolving the problems with the real economy and financial markets.

The assumptions underlying the outlook are supportive of growth. Both short-term and long-term interest rates are expected to rise moderately throughout the outlook horizon. In 2016 the three-year Euribor rate is predicted to average 0.7% and the ten-year interest rate 2.7%. The interest rate forecasts are almost one percentage point lower than a year ago. The euro to dollar exchange rate is anticipated to fall slightly, remaining at around 1.3 through to the end of the outlook period. Oil and other raw materials prices are expected to show only little movement from their current levels.

In 2014 Finnish GDP is expected to show zero growth. If output had remained unchanged from last year, this year's GDP figure would have shown negative growth of 0.1%. The forecast therefore includes a very moderate economic upturn, with this year's internal growth moving into positive territory. Goods and services exports will increase by 0.4%, while imports will continue to fall. Net exports have a definite positive impact on economic growth, and they are the most significant growth-driving factor this year. The sluggishness of imports is due in part to the weakness of private consumption. In 2014 private consumption will show no increase from last year because of sluggish real purchasing power. Furthermore private consumption is supported neither by expectations of future economic development nor by the situation in the labour market. Private investment will fall by 4.6% mainly as a result of sluggish investment in residential construction and investment in machinery and equipment. It is forecast that industrial production will continue to slide for the fourth year running, showing a fall of just over 2% this year. Service production is expected to turn to very moderate growth this year. The situation in the labour market will continue to deteriorate. The unemployment rate is expected to edge up to 8.6%, and employment will fall by 0.4% from the previous year. Productivity measured in working hours will rise by no more than some half a per cent, and it will continue to remain weak over the outlook horizon. Inflation will come in at 1.1%

In 2015 growth will pick up to 1.2% and become more broadly based. The main reason why this figure has been revised downwards since the June forecast lies in weaker than anticipated exports. Private consumption will increase somewhat, by 0.3% from last year, even though household real disposable income has stagnated. The slight improvement in the employment situation and the rebound of economic activity should help to dissipate the sense of uncertainty among consumers. The household savings rate will continue to fall and the household debt rate will turn to a slight downward trend. Exports will grow by 4% in the wake of rebounding world trade. However exports growth will be slower than world trade growth, and therefore the loss of market shares will continue. The rebound of imports is mainly driven by the recovery of investment. The only investment item showing no growth in 2015 is R&D investment. On the supply side, industrial production will increase slightly, edging up by just over one per cent. With the rebound of industry and the moderate growth of domestic demand, the production of services will also increase by close to 1½%. The situation in the labour market will continue to remain weak. Unemployment will edge down to 8.5% from the year before and employment will increase by close to half a per cent. Labour market mismatch problems remain significant, and the level of structural unemployment is high. It is forecast that inflation will remain at around 1½%.

In 2016 economic growth is predicted to come in at 1.4%. This growth will increasingly be driven by domestic demand. The contribution of net exports will also remain positive, although it is thought that Finnish exports will continue to grow more slowly than world trade. Although growth is sluggish, GDP growth in 2016 will outpace potential output. In 2014–2016 cumulative growth will come in at no more than 2.6%.

Persistent cyclical weakness in the economy has resulted in a long-standing deficit in public finances, although the government's adjustment efforts have helped to curb the growth of the deficit. The general government budgetary position is exacerbated by increasing expenditure associated with population ageing. The general government sector that is affected most by cyclical fluctuations is central government, particularly because of the high cyclical sensitivity of tax revenue. Central government is in deep deficit. However over the outlook period the deficit will shrink in response to adjustment efforts and rebounding economic growth. Over the outlook period local government finances will be adversely affected by weak tax revenue growth, cuts in central government transfers to local government, and the growing demand for social and health care services. It is projected that local government finances will remain in deficit over the next few years. Earnings-related pension institutions are the only general government sector that is in surplus.

In the light of recent events the risks of the forecast are still predominantly skewed to the downside. Even though it is difficult to quantify the economic effects of the Ukraine crisis, it is clear that a prolongation of the crisis would carry significant negative risks. An economic downturn in Russia would also reduce trade with third countries, and this spillover effect might be greater than predicted. It is anticipated that under conditions of a prolonged crisis and an economic downturn, the rouble would weaken, which would adversely affect the purchasing power of Russian people. Recovery in the euro area remains slow, and there are marked differences between member countries. Based on the latest figures from the summer, there is the risk of some major euro area countries sliding back into recession. Improving the competitiveness of the euro area would require structural reforms. In the current situation it is also extremely difficult to forecast the future development in financial markets and the banking sector. The European banking sector has moved towards increasing stability, but it will take some time to defuse all the known risks.

Domestically the main risks come from the development of the real economy. An improvement of public finances is only possible under conditions of favourable real economic development. At the moment, however, it seems that economic growth in Finland will be slower than in many competitor countries, and any restructuring efforts will only begin to have the desired effects in the medium term. The importance of maintaining a credible economic policy cannot be overstated. Improving the budgetary position of general government will continue to require discretionary measures designed to strengthen the conditions for economic growth, to raise the employment rate and increase the efficiency of public finances.

Economic growth will require access to factors of production at a competitive price. There is an urgency now to put measures into place that will enhance the efficiency of the labour market. In the international competition for market shares, labour input costs are a critical factor. The prices of other production inputs are also important competition factors, but most of them are priced in the international market place. In most industries labour-related costs are determined domestically. Resolving the mismatch problems in the labour market will require that the planned reforms in labour administration are put in place without delay. However these reforms will not alone suffice, but they must be backed up by tax and benefit changes that will encourage and promote the supply and mobility of labour.

Table 1. Key forecast figures

	2013* EUR bn	2011	2012*	2013*	2014**	2015**	2016**
		change in volume, %					
GDP at market prices	201	2.6	-1.5	-1.2	0.0	1.2	1.4
Imports	79	6.0	1.3	-2.5	-0.9	3.2	4.4
Total supply	280	3.5	-0.7	-1.6	-0.2	1.7	2.2
Exports	77	2.0	1.2	-1.7	0.4	4.0	4.6
Consumption	161	2.0	0.3	0.0	0.1	0.3	0.9
private	111	2.9	0.1	-0.7	0.0	0.3	1.1
public	50	-0.1	0.7	1.5	0.2	0.4	0.6
Investment	43	4.1	-2.5	-4.9	-3.7	2.4	2.9
private	34	3.8	-3.3	-6.8	-4.6	2.9	3.5
public	8	5.4	1.6	3.7	0.0	0.1	0.4
Total demand	281	3.4	-0.7	-1.3	-0.6	1.7	2.2
domestic demand	204	4.0	-1.4	-1.1	-0.9	0.9	1.3
		2011	2012*	2013*	2014**	2015**	2016**
Services, change in volume, %		2.8	0.5	-1.1	0.5	1.3	2.0
Industry, change in volume, %		-0.6	-8.4	-2.0	-2.2	1.1	2.3
Labour productivity, change, %		1.0	-2.1	0.6	0.6	0.7	1.2
Employed labour force, change, %		1.1	0.4	-1.1	-0.4	0.3	0.6
Employment rate, %		68.6	69.0	68.5	68.5	68.9	69.5
Unemployment rate, %		7.8	7.7	8.2	8.6	8.5	8.2
Consumer price index, change, %		3.4	2.8	1.5	1.1	1.5	1.8
Index of wage and salary earnings, change, %		2.7	3.2	2.2	1.4	1.2	1.5
Current account, EUR bn		-3.5	-3.9	-4.4	-3.1	-2.5	-2.4
Current account, % of GDP		-1.8	-1.9	-2.2	-1.5	-1.2	-1.1
Short-term interest rates (3-month Euribor), %		1.4	0.6	0.2	0.3	0.4	0.7
Long-term interest rates (10-year govt. bonds), %		3.0	1.9	1.9	1.5	1.6	2.2
General government expenditure, % of GDP		54.4	56.3	57.8	58.5	58.2	57.9
Tax ratio, % of GDP		42.1	42.9	44.0	44.4	44.3	44.5
General government net lending, % of GDP		-1.0	-2.1	-2.3	-2.7	-2.4	-1.7
Central government net lending, % of GDP		-3.2	-3.7	-3.5	-3.4	-2.6	-2.3
General government gross debt, % of GDP [1)]		48.5	53.0	55.9	59.6	61.2	62.1
Central government debt, % of GDP		40.5	42.2	44.6	47.6	48.5	49.0

[1)] Public debt is estimate by the Ministry of Finance also for years 2011, 2012 and 2013 due to the statistics revision. See box on page 70.

Macroeconomic surveillance in the EU

In the wake of the euro area crisis Member States have given the EU an increasing role in economic policy coordination. In addition to the surveillance of public finances, increasing focus has been given to macroeconomic stability. The idea behind EU-wide macroeconomic stability monitoring is to identify and eliminate potential risks to macroeconomic development in advance and to address any existing problems.

One of the lessons from the European debt crisis has been the realisation that macroeconomic instability in one euro area country inevitably spills over to affect other Member States. In 2011 provisions on multilateral surveillance in Article 121, paras 3 and 4 of the Treaty on the Functioning of the European Union were complemented with new specific regulations concerning the detection of macroeconomic imbalances and the prevention and correction of excessive macroeconomic imbalances within the Union.

This procedure includes the creation of an alert mechanism for the early detection of macroeconomic imbalances. The European Commission prepares an Alert Mechanism Report on such imbalances in all Member States annually. The report includes a scoreboard to monitor how each Member State has performed on 11 key indicators and to see whether any threshold values have been exceeded. The variables included are intended to describe economic risk factors in such areas as competitiveness, external balance, build-up of indebtedness, and housing market and financial sector liabilities.

In the Finnish case, macroeconomic problems have shown up in export market shares, for instance. According to the Commission's indicator Finland's export market share has fallen by almost 31 % in the past five years. This means that Finnish exports have developed more slowly than export market growth. One of the difficulties in monitoring threats to macrostability is that some of the indicators used are slow to react to changes observed. For instance, the indicator of export market share is based on average performance over the past five years, while nominal unit labour costs are described using three-year averages of percentage changes.

Based on these scoreboard assessments the Commission decides on the need for an in-depth review of the imbalances detected. In 2013, for instance, an in-depth review was conducted for 14 Member States, including Finland. These assessments of macroeconomic imbalance consider the severity of the imbalance as well as any economic and financial spillovers threatening the integrity of monetary union. If there is indication of a serious imbalance that poses a threat to economic and monetary union, the Council may decide to open an Excessive Imbalance Procedure. There is no automatic trigger for the procedure. In connection with an EIP, the Council will make recommendations to Member States and step up surveillance. Recommendations may also be made to countries whose imbalances are not considered excessive.

In the Finnish case it was thought that the most serious macrostability problems lay in modest potential growth prospects and weak competitiveness. The Commission's recommendations to address these problems included the stepping up of competition, paying closer attention to productivity trends in wage formation, and the provision of support for innovative businesses.

A Member State subject to the Excessive Imbalance Procedure shall submit to the Council and the Commission a plan on how it intends to address the recommendations, including proposed policy measures and a timetable for implementation. If the Council considers this plan inadequate, the Member State has two months to submit a new corrective plan. Once this plan has been approved, the Member State shall submit a progress report to the Council and the Commission at regular intervals.

If, based on the Commission's report, the Council is satisfied that the Member State has taken the corrective measures recommended, the Excessive Imbalance Procedure will be considered to be on track and shall be held in abeyance. However there might be a long time interval between the adoption of the corrective action and the actual resolution of the imbalance, and monitoring shall be continued throughout this period. The Commission may conduct enhanced surveillance missions to the Member States subject to the Excessive Imbalance Procedure. This procedure has never yet been used so there is no practical experience of how it works.

There are currently three Member States – Italy, Croatia and Slovenia – with an excessive macroeconomic imbalance. The determination of when a macroeconomic disruption or transgression of threshold values amounts to an excessive imbalance is necessarily open to interpretation. That interpretation will also be influenced by the scale of the actions taken by the Member State concerned to address the problems detected. Spain, for instance, has in recent years introduced a number of reforms to improve competitiveness and market performance. It may take some time for the full effects of these reforms to show up, so it is well justified that assessments of excessive imbalance consider not only the observed performance, but also the scale of the reforms carried out.

Medium-term outlook

The Finnish economy has contracted for two consecutive years. At the same time industry and the economy as a whole have been undergoing restructuring that has affected the longer term growth prospects of the economy. The economy is not yet expected to show growth in 2014, and even in the medium term it is thought that growth will be historically slow.

The medium-term outlook can be examined via potential output, which is thought to determine the economy's medium-term growth prospects. In its assessments of potential output the Ministry of Finance uses the production function method as developed jointly by the EU Commission and Member States, in which potential output growth is divided between projections of potential labour input, capital and total factor productivity. Potential output is an unobservable variable and its assessment during a strong economic cycle and under conditions of rapid changes in the production structure is challenging.

The decline in the working age population will reduce the overall labour input over the next few years, but on the other hand the labour participation rate is expected to increase somewhat, especially in older age groups. When the level of unemployment falls below the structural unemployment rate, upward pressures begin to emerge on wages and salaries. In practice this means that unemployment is above its structural level when real unit labour costs are falling, i.e. when wages rise more slowly than productivity and inflation taken together. It is estimated that Finland's structural unemployment level is somewhere around 7.2.%. Projections are that unemployment will begin to approximate this level in the medium term as the output gap closes. The trend of average hours worked will remain stable over the next few years. The contribution of labour input to potential output will average zero in the medium term.

Increasing total factor productivity growth has been a major driver of economic growth for the past few decades. However in recent years total factor productivity has increased only modestly. This slowdown has been attributed to both cyclical and structural factors. Output has dropped significantly in high-productivity branches, and at the same time the economy as a whole has become more service-oriented. The total factor productivity trend can be extracted from observed productivity based on the capacity utilisation rate and other cyclical indicators. In recent years total factor productivity trend growth has been around zero, and it is expected that in the medium term the growth rate will remain much slower than in the early 2000s.

Potential output is also affected by the existing capital stock. Several years of low investment have acted to slow capital stock growth and therefore undermined the economy's future growth potential. Overall it is projected that the economy's growth potential will rise to just one per cent by 2018.

The difference between total actual output and potential output, i.e. the output gap is negative when actual output is lower than potential output. This means there is idle capacity in the economy and output can grow more rapidly than potential output without creating price pressures. In 2014 the output gap is estimated to stand at –2.7% of potential output. In 2015–2018 it is predicted that the economy will grow at an average annual rate of

1.4%. According the EU's common production function method, Finland's potential output growth is slower, on average ½ % per year, so this will result in a contracting output gap. It is projected that the output gap will close in 2018 when unemployment is expected to approximate its structural level, the labour participation rate is at its trend level and total factor productivity growth is equivalent to trend growth once all idle production capacity has been put to use.

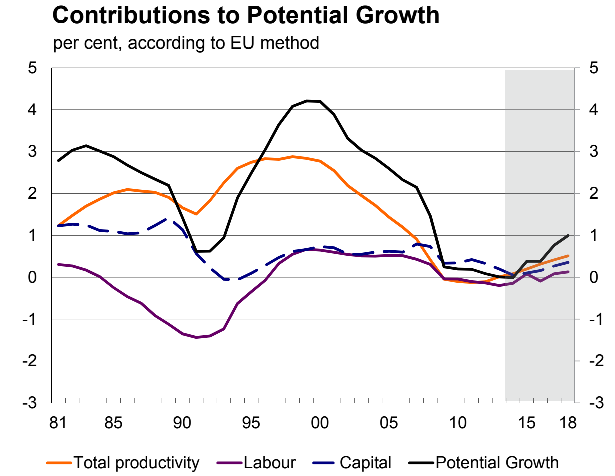
Public finances have deteriorated as a result of persistent cyclical weakness, but population ageing and other structural factors have also begun to weigh down on public finances. The slowdown of potential growth is having an adverse effect on the structural financial position of general government as economic growth and therefore tax revenue growth are expected to remain subdued in the years ahead. Despite the adjustment efforts that have been made, public finances are in structural deficit. The public debt to GDP ratio will exceed the 60% threshold in 2015, and will continue to rise in the medium term.

Table 2. Key forecast figures for the medium term

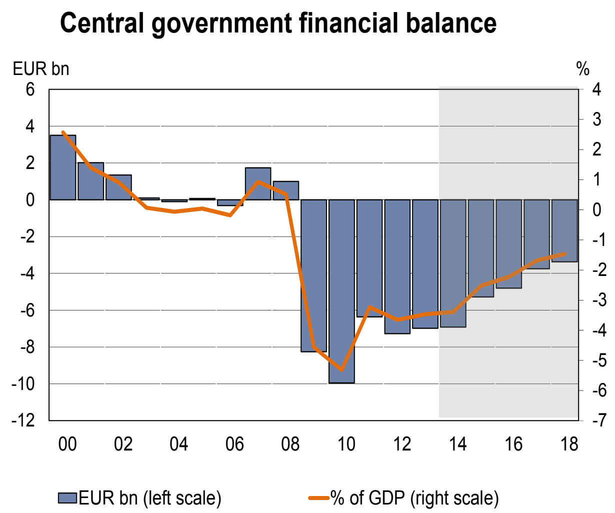
	2012*	2013*	2014**	2015**	2016**	2017**	2018**
GDP at market prices, change in volume, %	-1.5	-1.2	0.0	1.2	1.4	1.4	1.4
Consumer price index, change, %	2.8	1.5	1.1	1.5	1.8	1.8	1.8
Unemployment, %	7.7	8.2	8.6	8.5	8.2	7.8	7.5
Employment rate, %	69.0	68.5	68.5	68.9	69.5	69.6	70.0
General government net lending, % of GDP	-2.1	-2.3	-2.7	-2.4	-1.7	-1.1	-0.9
Central government	-3.7	-3.5	-3.4	-2.6	-2.3	-1.8	-1.5
Local government	-1.1	-0.8	-0.8	-1.1	-1.1	-1.1	-1.1
Social security funds	2.6	1.9	1.5	1.3	1.7	1.8	1.8
Structural balance. % of GDP	-1.2	-0.8	-1.2	-1.3	-1.2	-0.9	-0.9
General government gross debt, % of GDP [1)]	53.0	55.9	59.6	61.2	62.1	62.4	62.6
Central government debt, % of GDP	42.2	44.6	47.6	48.5	49.0	48.9	48.7
Output gap, % of potential output [2)]	-1.5	-2.7	-2.7	-1.9	-0.9	-0.3	0.0

[1)] Public debt is estimate by the Ministry of Finance also for years 2011, 2012 and 2013 due to the statistics revision. See box on page 70.

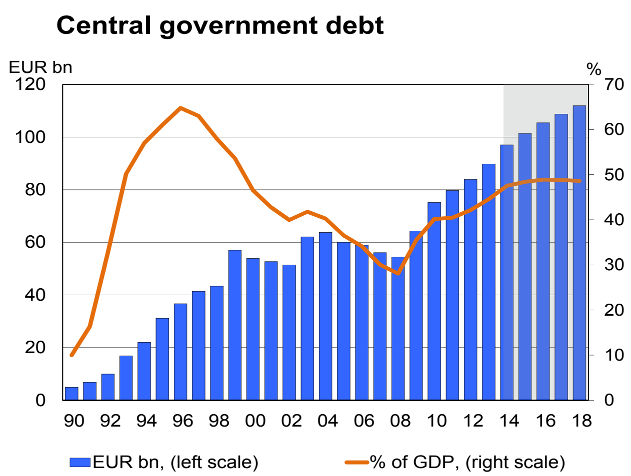
[2)] Estimated according the method developed jointly by the EU Commission and Member States.



Source: MoF



Sources: Statistics Finland, MoF



Sources: State Treasury, MoF

Fiscal policy

Finland's public finances are in a poor shape and the outlook is bleak. The recession pushed general government firmly into deficit. Even though growth is now recovering and output in the economy is gradually approaching the amount of labour and capital available in the economy as well as its potential productivity level, growth will still remain subdued. Sluggish investment and industrial restructuring are effectively hampering productivity growth. The changing demographic structure is reducing the amount of labour available in the economy and will continue to drive up age-related pension and health care expenditure over the next 20 years or so.

The growth of age-related expenditure is undermining the structural budgetary position of general government that is independent of the cyclical situation. This is happening at a rate that if tax rates remain unchanged and the foreseeable economic development remains within normal range, general government revenue will not be sufficient to cover general government expenses. Without corrective measures, public debt to GDP is threatening to spiral out of control. General government finances are not on a sustainable basis in the long term.

Under these conditions it is imperative to strike a balance in fiscal and other economic policy realms in order to carry domestic demand through the recession, to halt the growth of public debt in the medium term, to improve the conditions for economic growth and to ensure the sustainability of public finances in the long term.

As the economy is in recession and its resources are underused, government actions can help to increase short-term demand in the economy. On the other hand it is important that steps are taken to restore structural balance in public finances in the same pace as output moves back towards its potential level. Substantial immediate adjustment measures later on in a situation where the economy has already returned to balance would push the economy back into recession and derail it from the balanced growth track determined by production conditions. There is no upturn in sight where adjustment measures might be needed for cooling down purposes.

The fiscal and other economic policies of the Governments of Prime Minister Jyrki Katainen and Prime Minister Alexander Stubb have been driven by the concrete objectives of reducing the central government deficit to no more than 1% and achieving a substantial reduction in central government debt to GDP by the end of the electoral term. Government policy has also had the medium-term objective of a structural deficit for public finances of no more than 0.5% of GDP as well as the target of meeting the maximum reference values for public deficit and debt specified under the EU Stability and Growth Pact. The two Governments have also have been committed to restructure the economy in a manner that supports economic growth and the sustainability of public finances. In addition the Governments have introduced various temporary and carefully targeted measures intended to support domestic demand.

As economic growth and employment have remained weaker than predicted and growth prospects are subdued, the targets set for central government finances have slipped beyond reach. During their terms in office the sitting and the former Government have decided on measures that will reduce central government expenditure and increase revenue by a net total of some EUR 6.4 billion at an annual level in 2018, i.e. 2.8% of GDP when compared to the last central government spending limits decision of the previous electoral term.

Despite the Government's adjustment efforts central government's deficits will remain high. However the public debt-to-GDP ratio will stop rising in 2017. The structural position of public finances is threatening to deviate significantly from its target. The risk of significant deviation means that the matter will be addressed both at EU and national level, as national legislation requires that the Government take corrective action when presented with evidence of a deviation. For public finances to be on a sustainable basis, the structural budgetary position should be much stronger than targeted.

Finland's public debt is continuing to grow and will exceed 60% of GDP in 2015. However it is not thought that violation of the public debt criterion will trigger the excessive deficit procedure as it will be due in part to solidarity operations to support other euro area countries and the unfavourable cyclical conditions.

The Government of Prime Minister Jyrki Katainen announced a new structural policy programme aimed at improving the conditions for economic growth and at closing the sustainability gap in August 2013. The programme was updated in November 2013 and March 2014. The Government of Prime Minister Stubb is committed to implement the programme and in connection with its summer 2014 spending limits discussions announced decisions that will keep the programme on track.

The Government's structural policy programme specifies the key elements that are needed to restructure the economy in a manner that supports economic growth and the sustainability of public finances: the budgetary framework and other joint central and local government actions aimed at restoring balance in municipal finances, steps to improve the productivity of service provision by restructuring social and health care services and financing arrangements, and the extension of work careers through the pension reform and other measures focused on the beginning of and breaks in the labour market career. In addition the programme includes numerous steps to lower structural unemployment and to increase the efficiency of the housing market. The Government's earlier decisions to reduce the corporate income tax rate, to revise the dividend income tax system and to promote the employment of young people all support the programme and form an integral part of the broader reform package.

Foreseeable economic growth and the return of output to its potential level are not alone enough to bridge the sustainability gap in public finances. The effective and full implementation of the structural policy programme in line with the targets set will allow the Government to make the best possible use of the resources available in the economy and pave the way for stronger long-term growth.

In the meantime it is crucial to solidify confidence in Finland's commitment to do everything necessary and in all circumstances to prudently manage its public finances and its ability to meet its obligations. This confidence will provide the room to manoeuvre that is needed to put in place the long-term measures that will secure the sustainability of public finances. Determined and disciplined implementation of the agreed measures will help to build up this confidence. Furthermore, the frontloaded reduction of central government deficits is important to preventing a vicious circle of escalating debt in the medium term, before the structural reforms have the chance to make an impact.

1 Economic outlook

1.1 Recovery of global economy overshadowed by geopolitical risks

Growth prospects among industrial countries are overshadowed by geopolitical tensions in Russia, the Middle East and elsewhere. So far, however, confidence has not deteriorated to the same extent as in some earlier political and currency crises. Although market risk premiums are back at the very low level that prevailed before the crisis and the price of oil has remained stable, continued high political uncertainty is deterring the recovery of investment.

The economic sanctions imposed by Western countries and the Russian import ban have only limited impact on Russia's and its trading partners' economic activity. The Russian state and central bank can, for instance, support the sanctions-hit banking system and so maintain the availability of lending. Nonetheless the growing climate of uncertainty is driving up interest rates in Russia, weakening the rouble, accelerating inflation, undermining investment and reducing imports. The food imports ban will continue to stoke inflation in Russia. Indeed these indirect effects of the crisis on Russian import demand are more significant than its direct effects.

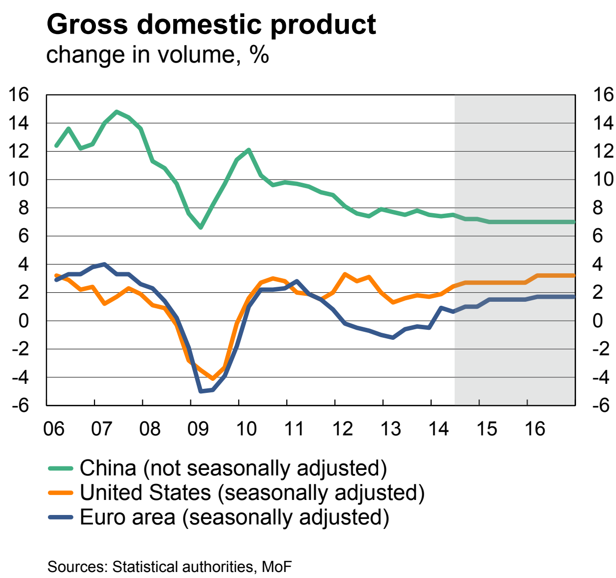
Russia will be hard pressed to avoid sliding into recession this year, even though the state can resort to a stimulus policy to boost demand. Continued high oil prices will no longer generate the kind of growth seen in recent years because of the shortage of capacity and low investment levels. The conditions for growth are held back by the country's inflexible economic system and markets as well as by the absence of innovations and growth enhancing structural reforms.

The core drivers of growth in the global economy are the United States and the UK, which are now shrugging off the long shadow of the financial crisis. The rebound in these countries is supported by improved private sector balance sheets, extremely slack monetary policy and less aggressive fiscal policy adjustment. In many developing economies, by contrast, growth over the forecast horizon will be significantly slower than usual.

In the United States, economic recovery is slower than from earlier recessions. Even though investment growth has rebounded, it will not reach its previous, 2005 peak level until 2015. Employment is improving very quickly, but high rates of long-term unemployment, the lowered labour participation rate and poor wage growth will hamper demand throughout the outlook period.

The fragility of growth in the euro area stems from the lingering effects of the debt crisis. In several Member States growth is hampered by poor competitiveness, which is limiting supply opportunities, and the adjustment of private sector balance sheets, which is holding back the acceleration of private consumption and investment. Furthermore high levels of public debt will effectively limit the options available to governments when responding to possible future shocks. In Europe the most promising economy at the moment is the UK, which has returned to robust growth despite substantial public sector adjustment.

In China, economic activity is dampened by sluggish demand from industrial countries and many developing economies, which cannot be fully offset by demand from the domestic market and other developing economies. Nonetheless the Chinese economy will continue to grow at around 7% throughout the outlook period, provided that the country's stimulus policy is successful.



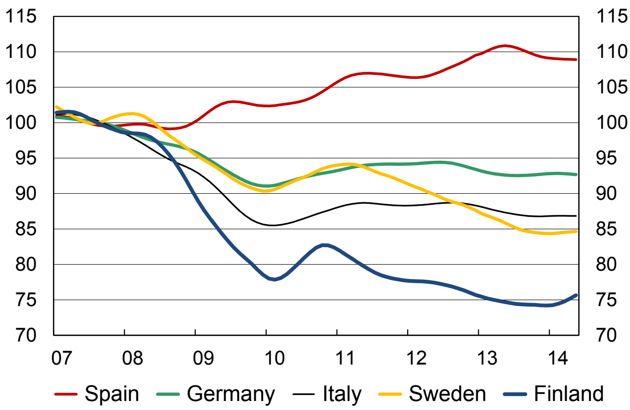
World trade continues to remain sluggish

At the height of globalisation in the 1990s and 2000s, imports by industrial countries typically grew at around twice the rate of industrial output growth. This rule of thumb no longer applies in the wake of the financial crisis. In recent years world trade has grown at more or less the same rate as output, partly because of weak investment demand. Trade growth will only slowly gather momentum towards the end of the outlook period as investment demand rebounds. The recovery of the global economy will no longer generate in Finland the same kind of demand surge that it used to, especially as we have lost substantial market shares in world trade since the financial crisis.

World trade
change in volume, %

Sources: CPB Netherlands Bureau for Economic Policy Analysis, Statistics Finland, MoF

Market share in goods exports[1)]
2007=100, trend (HP)



1) Ratio of goods exports growth to world trade growth

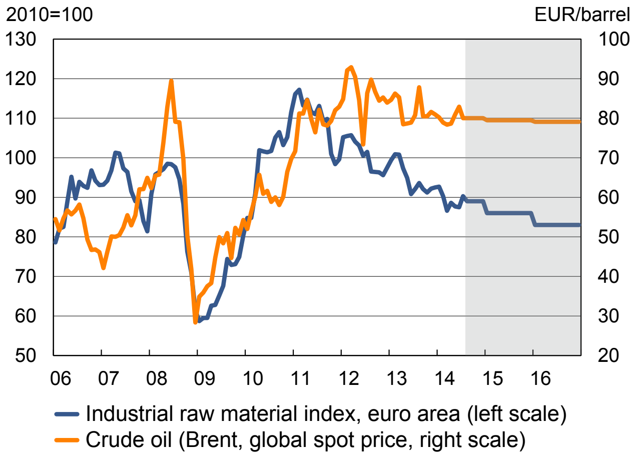
Sources: Macrobond, MoF

Inflation pressures moderate

Inflation expectations in the financial markets are moderate, allowing central banks to persist with an unusual monetary policy stance. Crisis countries in the euro area are struggling to avoid deflation, but in the euro area as a whole the risk of deflation is extremely low. In crisis countries interest rates on bank loans are still significantly higher than in the countries with the best credit ratings, which is deterring both consumption and investment. Interest rates will rise very slowly over the outlook period.

Prices of crude oil and other raw materials will fall moderately over the outlook period with the slowdown of demand and high levels of supply in developing economies. Increased geopolitical risks in oil producing countries have so far not been reflected in oil prices, but the crises certainly carry the risk of a sharp rise in the price of oil and other raw materials.

Raw materials prices
EUR



Sources: Hamburgisches WeltWirtschafts Institut, Macrobond, MoF

Risks becoming more balanced

In the euro area risks are still predominantly on the downside as the recovery of households from the debt and financial crisis may take even longer than predicted. Sluggish private sector demand for credit may push consumption or investment back onto a downward track, and the risks may even cause the crisis to flare up again. It is also unclear how seriously indebted economies will work to restore their balance sheets.

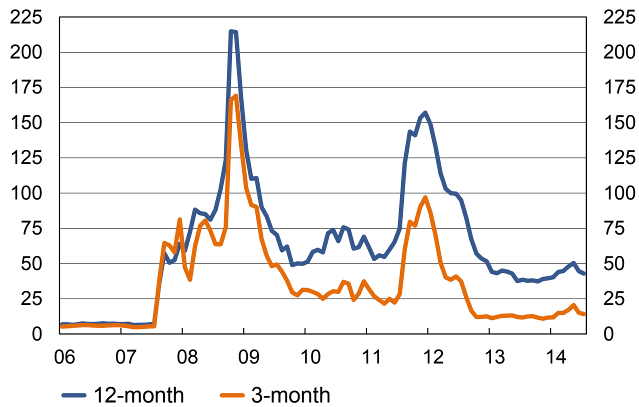
If the crisis in Ukraine persists, that would inevitably have the effect of adding uncertainty and possibly increasing the outflow of capital from Russia, reducing investment, further weakening the rouble and deepening the recession in Russia.

In the United States, the improved net real investment position in the private sector may push demand onto a stronger than predicted growth track. Furthermore, given its relatively low energy costs, the United States is well placed to improve its industrial base and price competitiveness.

Uncertainty hangs over both Japan's policy experiments in general and over the extent and timing of their effects. The reforms may act to dampen demand before their beneficial effects on productivity and employment begin to filter through to the economy. For example, the VAT hike that was necessary to increase the stability of public finances has severely curtailed demand in Q2 2014.

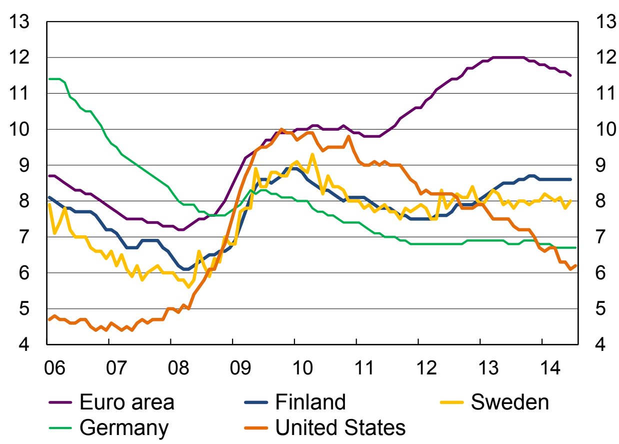
Low interest rates in industrial countries and a stronger tendency to risk-taking have steered investment flows and the market for some assets may have overheated. The end of unconventional monetary policy and rising interest rates are now looming on the horizon, and the need to adjust will inevitably cause strong reactions in the financial markets.

Banking system risks
difference between secured Euribor and unsecured Eonia interest rate swap yield, basis points



Source: Macrobond

Unemployment rate
seasonally adjusted, %



Sources: Macrobond, statistical authorities

Table 3. Gross domestic product

	2011	2012	2013	2014**	2015**	2016**
	change in volume, %					
World (PPP)	3.9	3.2	3.2	3.4	3.9	4.0
Euro area	1.5	-0.5	-0.5	1.0	1.5	1.7
EU	1.6	-0.4	0.1	1.4	1.9	2.1
Germany	3.4	0.9	0.5	1.7	2.2	1.5
France	2.1	0.4	0.4	0.7	1.2	1.5
Sweden	3.0	1.3	1.6	2.5	2.5	2.7
United Kingdom	1.1	0.3	1.7	3.0	2.7	2.2
United States	1.8	2.1	2.2	2.7	2.7	3.2
Japan	-0.4	1.5	1.5	1.5	1.5	1.2
China	9.6	7.8	7.6	7.2	7.0	7.0
Russia	4.3	3.5	1.2	-1.0	0.0	1.5

Sources: Eurostat, statistical authorities, IMF, MoF

Table 4. Background assumptions

	2011	2012*	2013*	2014**	2015**	2016**
World trade growth, %	6.1	1.9	2.7	3.2	4.7	5.7
EUR/USD	1.39	1.29	1.33	1.35	1.32	1.29
Industrial raw material price index, EA, € (2010=100)	109.6	100.7	94.8	89	86	83
Crude oil (Brent), €/barrel	79.7	87.1	82.0	80.0	80	79
3-month Euribor, %	1.4	0.6	0.2	0.3	0.4	0.7
Government bonds (10-year), %	3.0	1.9	1.9	1.5	1.6	2.2
Export market share (2000=100) [1)]	82	81	78	76	75	75
Import prices, %	6.1	2.5	-1.1	-0.5	1.3	1.4

[1)] Ratio of export growth to world trade growth.

Sources: Statistical authorities, CPB, HWWI, Reuters, MoF

Finland’s declining export demand: some simulations

The Ministry of Finance Economics Department’s KOOMA model is used for assessing the economic impacts of decline in foreign demand for exports and for studying ways in which to mitigate the associated adverse effects by income or fiscal policy means. In all scenarios the economy is initially faced with a 5% negative external demand shock. The baseline scenario describes the overall economic effects of this shock, while the alternative scenarios examine the role of a more flexible wage formation or expansionary fiscal policy. The analysis covers the period from 2015 to 2025. The results are reported in relation to a steady state path, such as the Ministry of Finance’s outlook forecast as set out in its Economic Survey.

In the baseline scenario a 5% fall in export demand reduces Finnish GDP by more than one per cent as a result of lowered net exports. Imports are reduced to a lesser extent than exports as part of imports go directly to consumers. The excess supply created in the economy exerts downward pressure on prices, which contributes to slightly mitigate the negative effects on export volumes and to increase domestic demand for products.

The negative demand shock adversely affects the outlook of export companies and domestic production, which will slightly depress nominal wages, despite the assumption that wages do not immediately adjust to changes occurring in the economy. Consumer prices will fall slightly less than wages, and therefore negative real wage growth will act to depress private consumption. As businesses’ profit expectations are down, there are fewer new job vacancies than before and the unemployment rate will edge up. With private consumption, employment and nominal earnings all on the decline, central government tax revenue will also suffer as a result of reduced tax bases, while public debt to GDP will increase.

The decline in export demand means that Finnish GDP will show slower growth over the next two years than in the steady state path. However in the third year the outlook for export companies and domestic production will begin to improve as a result of declining real wages and relative export prices. Companies will step up production and announce new job vacancies. The unemployment rate will start falling and the employment situation will improve. Since the simulation is based on the assumption of upward wage rigidity, slower than steady state path earnings growth means that employment will improve more strongly than in the steady state path. Exports will begin to pick up and imports will fall only marginally as private consumption begins to climb back to the steady state path. As a result GDP growth will outpace the steady state path.

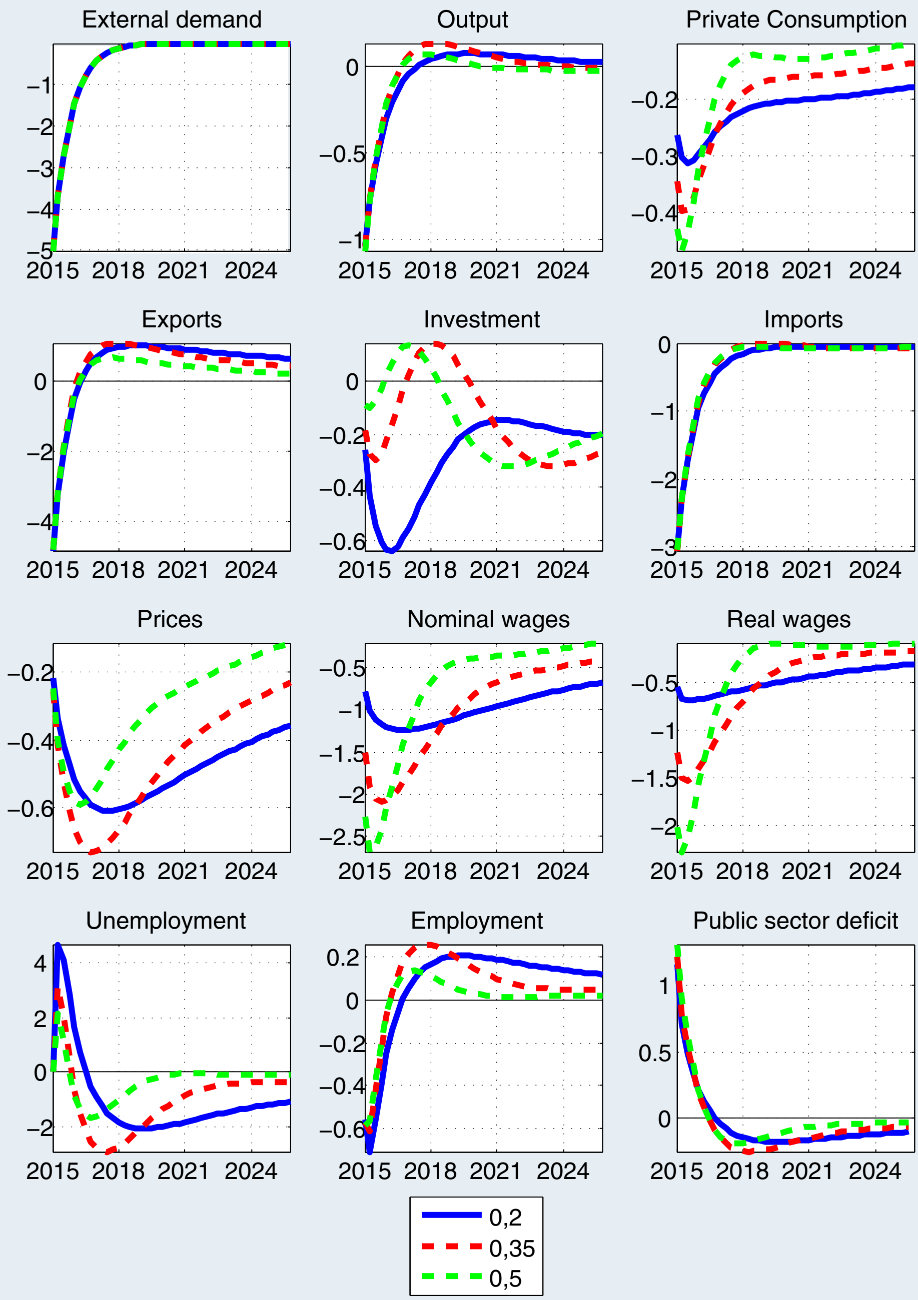
More flexible wage formation

The first alternative simulation assumes that wages adjust more rapidly to changes in the economy. While the baseline simulation assumes that only 20% of all wages can be renegotiated during each quarter, the figure in the alternative scenario is 35% or 50%. A more flexible wage response has hardly any immediate effect on the negative demand shock on net exports and GDP. However as nominal wages are more quickly adjusted to the reduced level of demand, private investment declines much less sharply than in the baseline scenario and the rise in unemployment is less than half the rate indicated by the baseline scenario. Real wages react more strongly than in the baseline scenario, and therefore the initial fall in private consumption is sharper.

As in the baseline scenario, the lowered level of demand puts downward pressure on prices. Falling export prices and reduced labour costs contribute to increasing business sector profits. Increased wage flexibility allows wages to adapt more quickly with the improving situation than in the baseline scenario. As a result the fall in private consumption is short-lived and total output recovers more quickly. GDP growth is faster than in the steady state path for a few years.

Cyclical wage flexibility has only a minor effect on interannual GDP variation, but significantly reduces cyclical unemployment variation. This is important because even a cyclical increase in unemployment adds to the risk of structural unemployment growth.

External demand shock with different wage rigidities



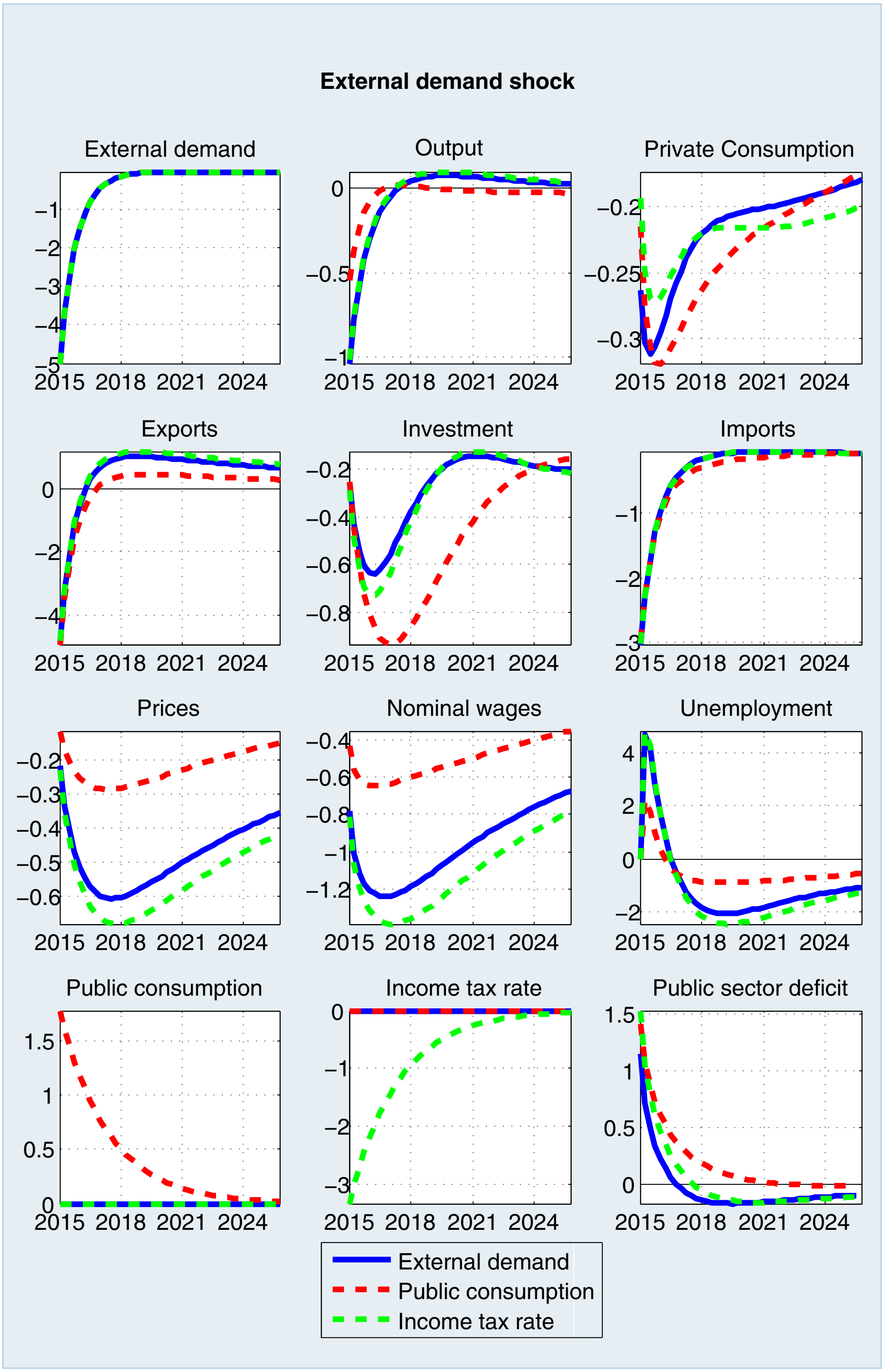
Expansionary fiscal policy

The second alternative simulation assumes that government follows an expansionary fiscal policy in order to mitigate the effects of recession triggered by the external demand shock. The simulation compares the effects of increasing public expenditure with lowered taxes on wages. The results show that fiscal stimulus can to some extent help mitigate the recession caused by reduced export demand, but this policy comes at a price for the management of public finances. Another conclusion from this analysis is that in the short term, lowering taxes on wages is not a very effective stimulus measure, but it does improve growth prospects in the medium term.

All in all an expansionary fiscal policy can only have a minor mitigating effect on the decline in GDP growth, but on the other hand policy choices have quite a significant effect on the structure of the economy. Fiscal stimulus has an immediate mitigating effect on the downturn because public consumption is part of GDP. However increasing public expenditure displaces private consumption and private investment in particular, which at the end of the review period is more than 5% lower than in 2014 and some 2.5% lower than in the absence of any fiscal stimulus. Since in this case the negative demand shock is in part neutralised by a positive (public) demand shock in the opposite direction, both prices and wages show less adjustment than in the baseline calculation. This means that, in contrast to the baseline scenario, nominal economic adjustment will not suffice to turn GDP onto a faster growth track than in the steady state path.

Tax stimulus has only a very moderate short-term effect and therefore cannot be considered an effective policy instrument for purposes of cyclical adjustment. According to the simulation it does, however, make for sensible structural policy since it has a positive effect on dynamic growth. For this reason the cumulative decline in GDP due to the export demand shock is the lowest in the tax stimulus scenario. The positive growth effects are most apparent in the labour market. Reduced taxes on labour allow for lower nominal wages than in the baseline calculation, without any adverse effects on disposable income, and therefore employment will in this case show the strongest growth even though private consumption follows a similar path as in the baseline calculation.

Fiscal policy stimulus does of course always add to the burden of public debt, but again this will depend on the choice of policy tool. At the end of the period under review in 2025, the baseline public debt to GDP ratio without stimulus is 0.4 percentage points lower than in 2014; with tax stimulus it would be 0.2 percentage points higher; and in the case of fiscal stimulus 2 percentage points higher than in 2014.


External demand shock
External demand
Output
Private Consumption
Exports
Investment
Imports
Prices
Nominal wages
Unemployment
Public consumption
Income tax rate
Public sector deficit
2015 2018 2021 2024
External demand
Public consumption
Income tax rate

Russia

Economic sanctions imposed by the EU

Since March this year, the European Union has progressively stepped up its restrictive measures on Russia in response to the situation in Ukraine, first by announcing a freezing of assets and travel bans on designated individuals and entities. Later on sanctions were imposed to restrict access of Russian state-owned financial institutions to capital markets, and EU citizens were banned from investing in bonds, stock indexes and other financial instruments of Russian state-owned financial institutions.

Furthermore the EU imposed sectoral restrictions. The import and export of defence materiel and the export of dual use items intended for military end use are prohibited. Products going to the Russian army are automatically defined as military end use. In addition there is a separate list of banned export items used in Arctic, deep water or shale oil exploration. This ban is designed to intervene in the long-term development of this sector and has no effect on the current availability of oil. The EU also limited the provision of services and funding related to the said products and their export.

Import restrictions imposed by Russia

The Russian Federation announced on 7 August 2014 an import ban on meat and meat products, milk and dairy products, root crops, vegetables, fruit and nuts, vegetable fat based foods and fish and shellfish from the EU, the United States, Canada, Australia and Norway. The Russian ban is effective for one year. Pork has been on the banned imports list since January following the spread of African swine fever in the EU area. The ban does not apply to imports by private individuals nor to products intended for consumption by children.

Direct effect of sanctions

EU's sectoral restrictions have only very limited direct effects on the Russian economy as a whole. The sanctions will especially reduce the level of foreign investment in oil exploration and in unconventional oil sources.

The sanctions on capital markets have limited direct effects on the Russian economy through Russian businesses or banks targeted by the sanctions. Both state-owned companies and virtually all major state banks have very low foreign debt with less than one-year maturity. Financing is less important in the Russian economy than in more advanced economies. The sanctions will have an adverse impact on the access of companies and banks to financing, on their costs and other credit terms as well as on the Russian stock market.

It is quite easy to find alternatives to basic financial operations such as the acquisition of assets. Companies and banks may resort to their liquid assets in order to service existing debts. In addition some funding can be secured from other markets and the domestic banking sector. In the last instance any shortfalls in financing can be met by using assets of the Russian state or by turning to the central bank and state banks.

The sanctions on capital markets have no significant direct effects on Finland or on Finnish financial institutions. Likewise the sectoral sanctions are on products where there is only very little trade between Finland and Russia. Although the overall economic effects of the sanctions on Finland are negligible, individual companies may be very severely affected.

The ban on food imports covers more than 30% of Russia's meat and vegetable consumption and more than 40% of its dairy products consumption. In the short term it is impossible for Russia to fill this gap by stepping up its own production or imports from Asia and Latin

America. The ban will inevitably drive up food prices and push inflation higher by some 2 percentage points in 2014.

Finnish food exports to Russia will drop to less than one-quarter of normal levels. The immediate effects will be the most severe for dairy products. In 2013 Finnish exports of now-banned products to Russia amounted to around EUR 283 million. The effects on food exports will bring domestic agricultural production and the dairy sector in particular under intense pressure. At the same time banned agricultural producers from across the EU will be seeking to make the most of the internal market and searching for alternative markets.

The reorientation of Russian imports opens up new export opportunities. In the worst case the dairy products that used to go to Russia can be replaced by sales of butter and milk powder to other destinations or to the EU intervention fund, which will reduce dairy sector export revenue by an estimated EUR 50–90 million. Although there are some companies that will be severely affected by the import ban, its overall economic impacts will be quite limited even in the worst case scenario, since total food exports to Russia account for less than 0.5% of overall Finnish goods exports. The MoF estimate is that Russia's counter-sanctions will reduce Finland's GDP in 2014 and 2015 by most 0.05%.

Indirect effects

The indirect economic effects of EU's sanctions are greater than their direct effects. The restrictions on financing in particular may have considerable indirect effects as foreign banks begin to limit the access of Russian companies to financing.

The greatest effects will come from the growth of uncertainty. Russian and foreign businesses and financiers as well as Russian households may decide to move capital out of the country and the rouble. This will cause the rouble to weaken, which will increase inflation and slow consumption growth. Furthermore investors in the real economy will become more cautious. The Russian-imposed import ban will drive up food prices and stoke inflation, further denting consumption.

With the rouble, consumption and investment all declining, Russian goods imports and foreign travel by Russians will also be adversely affected. The weight of these effects on Russia's trading partners, mediated via the trading channel and exchange rate reaction, will depend on the proximity of their trading relationship. A lowered level of activity among Russia's trading partners will also be reflected in the level of Finnish export demand.

In 2013 Finnish goods exports to Russia came to EUR 5.4 billion, while imports from Russia totalled EUR 10.5 billion. Goods exports to Russia accounted for around 9% of the overall value of exports and goods imports for around 18% of the overall value of imports. Russia is also a significant market for service exports. For instance, some 30% of all tourists to Finland come from Russia, and in 2013 they brought more than EUR 1.2 billion in revenue to Finland.

The share of domestic value added was higher in exports to Russia than in all exports on average. Wages, profits and taxes are paid out of domestic value added, which better describes the country's dependence on developments in the export country than the share of gross exports. Furthermore SMEs account for a significantly larger share of exports to Russia than exports on average. It is harder for SMEs than larger corporations to prepare for risks and to break into new markets, and therefore they are more exposed to the effects of negative shocks.

Economic situation in Russia

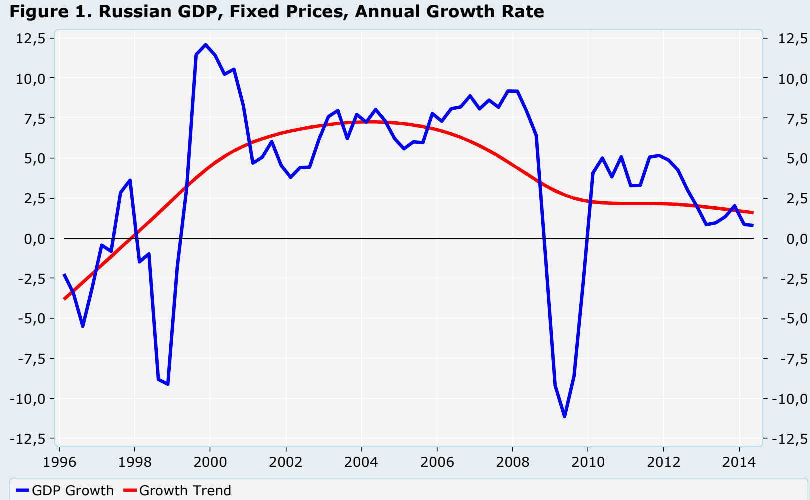
The Russian occupation and annexation of Crimea in February-March, the Russian actions to destabilise the situation in eastern Ukraine, the threat of sanctions and adverse developments in Russian domestic and economic policy have added to the uncertainty surrounding Russia.

Russia's economic growth rate slumped from around 2% in the last quarter of 2013 to just over 0.8% in Q1 and Q2 2014 (see Figure 1).

The Ministry of Finance predicts that Russia's GDP will fall by one per cent in 2014 and remain unchanged at this level in 2015. Although the growth of geopolitical uncertainty has pushed up interest rates in Russia, weakened the rouble, increased inflation and lowered investment and imports, the Ukraine situation as well as the sanctions and counter-sanctions are just a small speck in the economic challenges facing Russia. Economic growth has slowed as the reform of the country's economic system has been faltering. Continued high oil prices will no longer generate the kind of growth seen in recent years because of a shortage of capacity and low investment levels. The slowdown of economic growth in Russia will have the effect of reducing Finnish GDP by around 0.5% in 2014. These estimates are subject to considerable uncertainty, especially in a situation where households, businesses and the economy at large may suddenly decide on a change of direction.

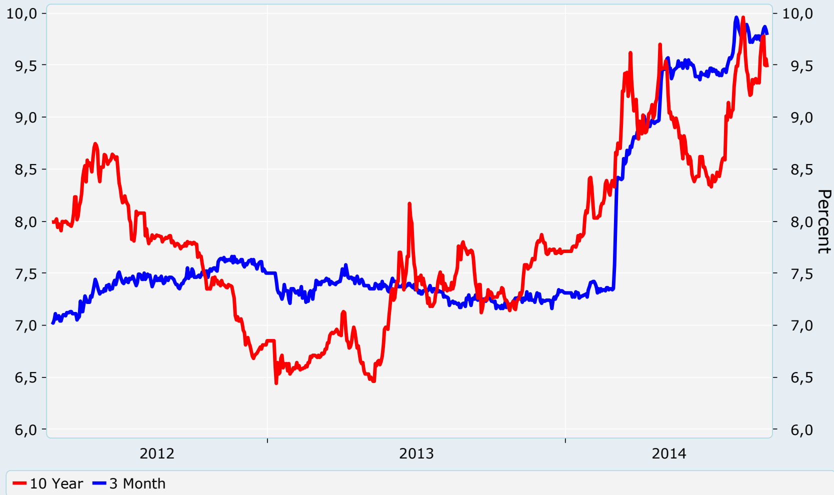
Taking a longer term view, the future development of the Russian economy rests in the hands of the country's own decision-makers. The depth of the uncertainty that now hangs over the country's economic development depends both on Russia's geopolitical decisions and its choice of economic and structural policy. Russia can ease the first problem by quickly and credibly reversing its policy of destabilising Ukraine, which would also reduce the threats surrounding the Western policy of sanctions. As for Russia's economic and structural policy, the situation seems harder to remedy. Russia's introversion is leading the country and its economy in the exact wrong direction. Russian has driven itself into a difficult vicious circle where both the turmoil in Ukraine and the bleak domestic economic outlook are adding to the sense of uncertainty and effectively hampering economic and structural reform. The problems started before the invasion of the Crimea, and they will continue after and beyond the Ukraine situation. Russia can afford a policy of stimulus that could bring some temporary relief, but that would only enhance the role of the public sector in the economy, which already is a big problem. Instead, Russia would need to move towards deep-going policy reforms and an opening up of its economy.

Figure 1. Russian GDP, Fixed Prices, Annual Growth Rate



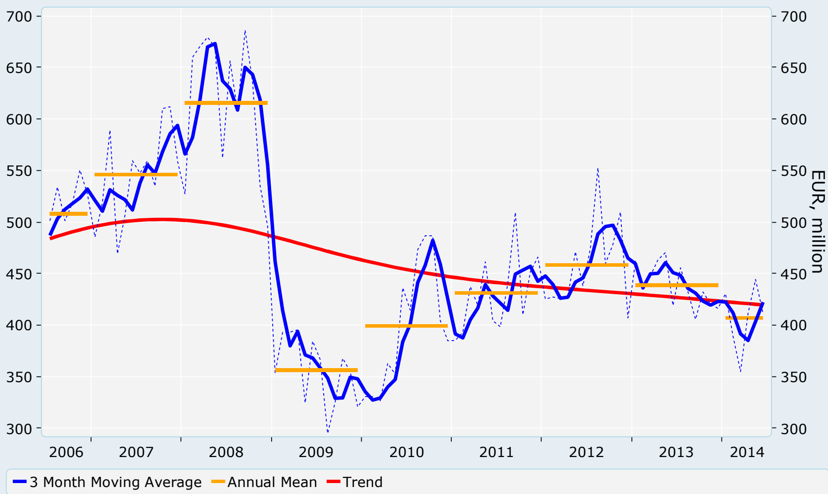
Source: Macrobond / MoF

Figure 2. Interest Rates in Russia



Source: Macrobond / MoF

Figure 3. Finnish Merchandise Export Volume to Russia



Source: Macrobond / MoF

1.2 Foreign trade

Exports to grow despite weaker outlook

According to the accounts published by Statistics Finland in July 2014, exports fell by 1.7% in 2013 and by equal amount in Q1 2014 from the previous observation. Exports have not grown since 2010, and the value of exports in Q1 2014 was some 3% lower than in 2010 on average. The decline in exports is driven by a number of factors, the most important of which have to do with ongoing structural changes in industry and Finland's reduced cost competitiveness.

Customs statistics for Q2 show that the value of exports was up by almost 3% over the previous quarter. Although this increase is driven by one-off events, eg. exports of transportation equipment, the growth in the early part of the year has been stronger than forecast in June. The forecast for the remainder of the year projects a fall in exports with the weakening short-term outlook, but even so the annual projection for 2014 is higher than the June forecast. The contribution of net exports to GDP growth will also be slightly higher.

Exports are projected to return to growth. This growth will be driven by the rebound of economic growth in Finland's most important export markets and by the gradual acceleration of global trade after a few quieter years. Euro area economic growth in 2014 will be faster than last year and investment will pick up, which will create growing demand for Finnish goods and services. Even though these projections have been revised down from the spring forecast, it is nonetheless expected that exports will increase in the latter part of the year.

Just over half of Finnish exports go to EU countries. The share of exports to the EU varies only marginally from branch to branch. Major industry branches such as the chemical, forest and metal industry account for over half of Finnish exports. Among these branches only the forest industry depends more on exports to EU countries than on exports to the rest of the world.

In 2015 export growth will reach 4% and in 2016 accelerate to 4.6% on the back of increasing global trade. Finland will continue to see its export market shares decline. European growth prospects and investment-based growth will not reach the growth rates recorded by developing economies in the outlook period. Reduced economic activity in Russia during the past year and over the outlook horizon will adversely affect Finnish export growth. The weaker export prospects are most clearly reflected in the 2015 forecast and in the lowered contribution of net exports.

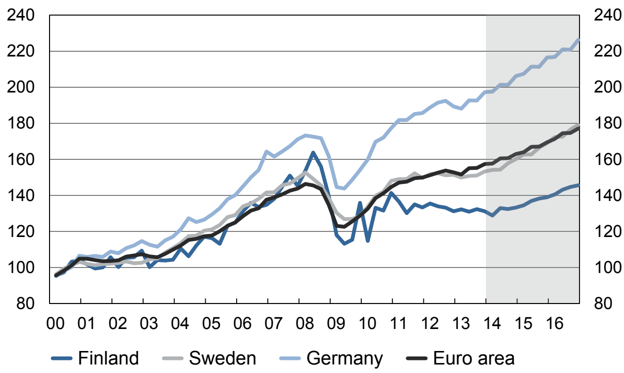
Table 5. Foreign trade

	2011	2012*	2013*	2014**	2015**	2016**
	change in volume, %					
Exports of goods and services	2.0	1.2	-1.7	0.4	4.0	4.6
Imports of goods and services	6.0	1.3	-2.5	-0.9	3.2	4.4
	change in price, %					
Exports of goods and services	4.5	1.2	-0.8	-0.6	1.4	1.5
Imports of goods and services	6.1	2.5	-1.1	-0.5	1.3	1.4

This forecast takes account of the fact that the trade sanctions imposed will loosen the connection between Russian GDP and imports. However there is also the risk that the adverse impacts of the sanctions may be greater than anticipated. These impacts may be directly reflected in a reduced volume of exports to Russia, but also indirectly in their undermining economic development in the rest of Europe. A more detailed discussion of the sanctions and their impacts on the Finnish economy is offered in a separate box on page 33.

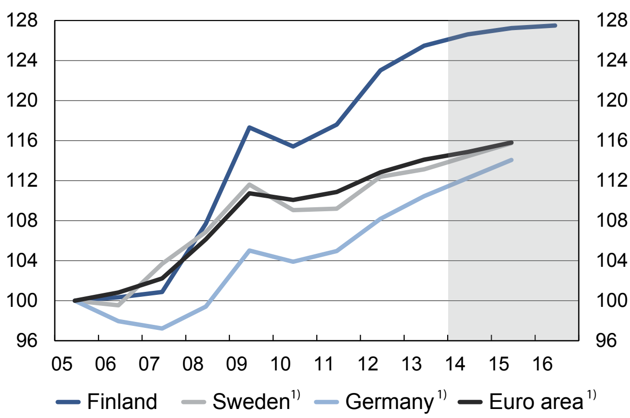
According to the July accounts Finnish imports fell by 2.5% in 2013. In Q1 2014, imports continued to decline by 2.9% over the previous quarter. Customs statistics show that imports have picked up during the second quarter of this year, again due to transport equipment sales. Imports are forecasted to return to growth as exports and domestic demand rebound in 2014, albeit slowly. The return of investment and consumption to growth will also contribute to drive imports growth in 2015 and 2016. As a consequence the contribution of net exports to GDP growth will decline during the outlook period.

Exports of goods and services
volume 2000=100, seasonally adjusted



Sources: Eurostat, MoF

Unit labour costs
2005=100, nominal



[1)] European Commission forecast

Sources: European Commission, Statistics Finland, MoF

Current account to remain in deficit

The July accounts update put the figure for the 2013 current account deficit at almost EUR 2 billion higher than the June forecast. The current account deficit stands at EUR 4.3 billion, or 2% of GDP. Because of problems in the export industry, domestic saving was considerably lower than previously forecast. Public saving was also at a lower level than previously forecast.

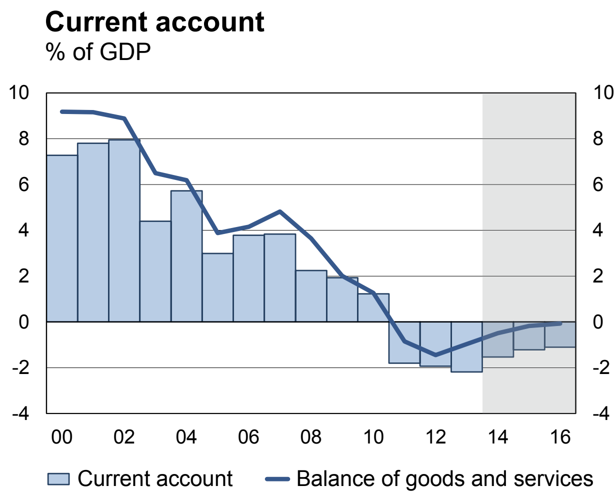
The July National Accounts update brought changes to foreign trade figures from 2012 onwards. Figures for the foreign trade of services changed more than others as they are based on questionnaire data compiled in the summer. Service imports and exports in 2013 were higher than previously estimated, but the deficit in the services balance was almost EUR 700 million bigger. As the value of goods exports declined and there was hardly any change in the value of imports, the trade balance deficit grew by almost EUR 600 million. The deficit in the balance of goods and services is now almost EUR 2 billion bigger than earlier estimated.

Over the outlook period the trade balance and current account deficit will contract by some two billion euros on the back of positive net exports, but even so the current account will show a deficit of EUR 2.3 billion or around 1% of GDP in 2016. Even though the sharp deterioration of the current account position can be attributed to structural problems such as the fall in electronics industry output, the factors behind the narrowing of the deficit during the outlook period are cyclical by nature. The pickup of external demand and export will see the current account move back towards balance. The rebound in investment will increase the output potential and allow the share of exports in GDP to return close to the level seen before the financial crisis.

The terms of trade have less significance than before to the development of the current account balance. Export and import prices will follow very similar paths as exports have become more diversified and export prices more closely follow those of competitors. Export and import prices will continue to fall, but the rate of this fall has now slowed, and it is forecast that prices will begin slightly to rise. However this rise will remain moderate as prices of oil and other raw materials will continue to fall. The terms of trade will improve over the outlook period, but only marginally. In Finland inflation in the closed sector is higher than in rival countries, which is reflected in a slightly higher rate of export price growth.

Table 6. Current account

	2011	2012*	2013*	2014**	2015**	2016**
	EUR bn					
Balance of goods and services	-1.7	-2.9	-1.9	-1.0	-0.4	-0.2
Factor incomes and income transfers, net	-1.9	-1.0	-2.5	-2.1	-2.2	-2.2
Current account	-3.5	-3.9	-4.4	-3.1	-2.5	-2.4
Current account, % of GDP	-1.8	-1.9	-2.2	-1.5	-1.2	-1.1



Sources: Statistics Finland, MoF

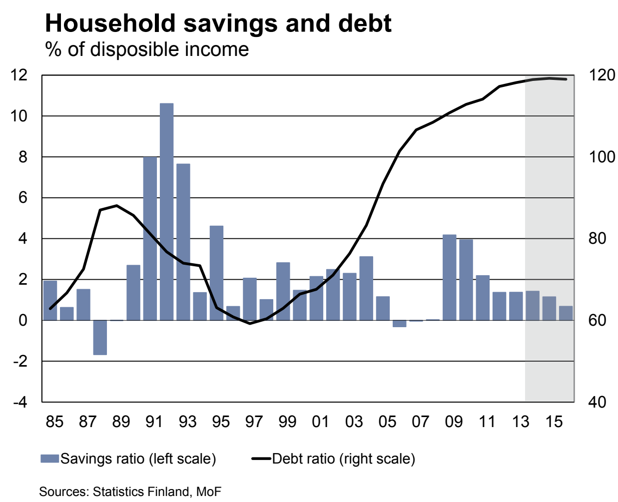
1.3 Domestic demand

1.3.1 Private consumption

Consumption depressed by weak real income development

In 2013 private consumption fell by 0.7 % as a result of weak household real income development. The last time a fall was recorded in private consumption was in connection with the 2009 financial crisis. Household purchasing power was also adversely affected by continued high inflation and the deteriorating employment situation. The rise in consumer prices was driven by tax base changes in indirect taxation. The fall in the household savings rate came to a halt with the spread of economic uncertainty among consumers.

Household confidence in the economy has improved slightly during the early part of the year. In June, consumer expectations were at their long-term average. Consumer concerns over unemployment have eased in late spring but still remain higher than usual. On the other hand consumers remain somewhat more cautious in their expectations about their own finances as compared to their outlook of the economy as a whole. Demand for durables reacts sensitively to changes in household expectations. Private transport equipment accounts for almost one-third of all durables. According to Consumer Survey data the proportion of respondents who were thinking of buying a new car increased during the spring. The number of new cars registered in January-July increased by just over 3 % compared to the year before. However in July the number of new car registrations was considerably lower than the year before. It is expected that during the remainder of the year both consumer durables and overall consumption will be lower than in the early part of 2014. In 2014 private consumption will be unchanged from last year.



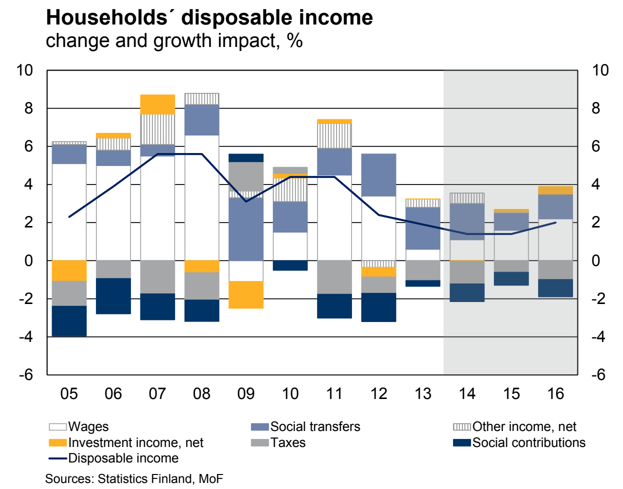
Retail spending has been exceptionally weak in the first half of the year. In January-July the volume of retail trade fell by 0.8 %. Sales expectations in the retail sector are at almost record low levels. Apart from declining household purchasing power, this is due to ongoing structural changes in the trade sector. In recent years changes in consumer purchasing behaviour have led to a significant growth in online shopping. In 2013 some 65 % of consumers purchased products or services online. This trend is forcing traditional retailers to rethink their strategies. With the increasing popularity of online shopping, the retail trade sector has faced increasing foreign competition.

Employment prospects critical to consumption growth

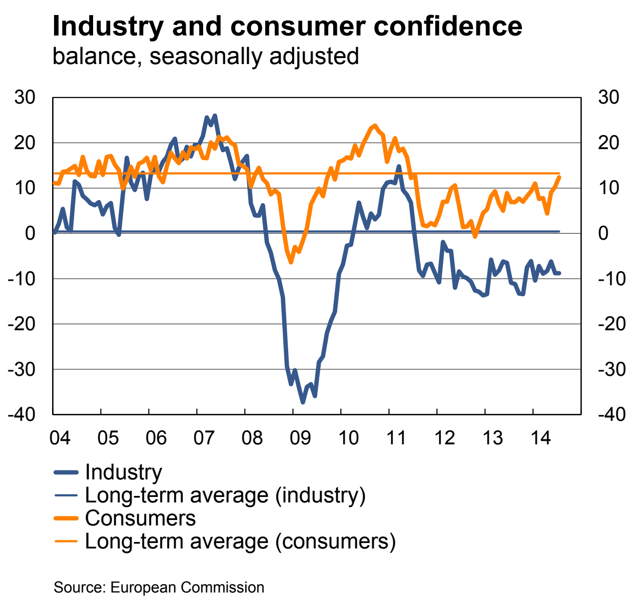
The single most important determinant of private consumption is employment. Wages account for around three-quarters of household incomes. In 2014 the number of employed persons is set to fall as a result of sluggish economic activity. Weak employment trends are known to increase household caution, especially in the housing market. Indeed it is expected that the number of housing sales will fall for the second year running. Longer sale cycles are also contributing to depress housing prices. Employment will only begin to improve in 2015 on the back of rebounding exports. The positive impacts on private consumption will take some time to filter through. In 2015 private consumption will turn to moderate growth. The forecast is based on the assumption of improving household confidence towards the end of the outlook period.

The weakness of income growth is well captured by the statistic that household real disposable income in 2014 is at the same level as it was in 2010. Real income will only begin to turn to growth towards the end of the outlook period. Government is very limited in the ways it can try to bolster household purchasing power over the next few years. The steps that are needed to halt the growth of public debt will inevitably have an adverse effect on household consumption opportunities in the short term. The tax reforms so far have been aimed at generating additional revenue from other sources than the taxation of labour. During the outlook period taxes on earned income will nonetheless increase with increasing social security contributions, and increasing expenditure pressures in municipal finances may further add to the overall tax burden. The restoration of external balance in the economy, which can only be achieved through improved competitiveness, will in turn require moderate earnings growth. In addition to wages, social transfers constitute another major source of household income formation. In 2013 social transfers amounted to EUR 39.7 billion, or 37 % of total household disposable income. Over the next few years the growth of social transfers will be fuelled by the increasing number of pensioners.

The stock of household credit has continued to grow. In particular, demand for consumer credit has been rising much more sharply than it did around the turn of the year. At year-end 2013 housing loans accounted for almost three-quarters of total household debt. The growth of housing loans has continued to slow down. Interest rates will edge up towards the end of the outlook period. Reduced tax deductions for interest paid on housing loans will also reduce the willingness of households to take on new debt. During the outlook period the household debt ratio will turn to a slight downward trend. Household debt is at roughly the same level as in the EU on average.



Even though real income growth has been very modest in recent years, consumer uncertainty has not been severe enough to lead to an increasing savings rate. Indeed the risk in the forecast for private consumption comes not only from weaker than predicted employment trends, but also from a marked deterioration in household confidence. This would lead to an increase in precautionary saving and a higher savings rate as happened in connection with the financial crisis.



1.3.2 Public consumption

Public consumption consists of central government, local government and social security funds consumption expenditure and amounts to some EUR 50 billion, around one-quarter of GDP and over half of total general government spending. The biggest single public consumption items are wages and social security contributions and intermediate consumption, i.e. the value of goods and services used as inputs. In 2013 the value of public consumption increased by 1.5%, but in the next few years this growth will be slower due to financial stringency in general government.

Central government consumption accounts for around one-quarter of total public consumption. The weak budgetary position in central government and the adjustment measures needed to address the problems mean that staff cuts are continuing in central government and at the same time the volume of consumption will decrease over the outlook period. Nominal consumption will nevertheless increase somewhat.

The local government sector accounts for two-thirds of public consumption. Local government consumption spending is driven by the growing need for services in the wake of the changing population age structure. However sluggish revenue growth and tightening finances mean that local authorities will have to curb expenditure growth during the current year. Over the next few years the growth of local government consumption will also be slowed by moderate cost increases. The forecast for municipal finances only takes account of measures already agreed, and therefore any adjustment measures taken by local authorities from 2015 onwards are not included in this assessment. It is estimated that local government consumption will increase by just under one per cent in 2015–2018.

Expenditure by social security funds consists mainly of wages and social benefits in kind paid out by the Social Insurance Institution Kela (reimbursements for medicines and travel and rehabilitation allowances). In 2015 the growth of expenditure on social benefits in kind will slow as a result of savings decisions taken by the Government.

Table 7. Consumption

	2013 share, %	2011	2012	2013	2014**	2015**	2016**
		Change in volume,%					
Private consumption	100.0	2.9	0.1	-0.7	0.0	0.3	1.1
Households	95.1	3.1	0.1	-0.7	0.0	0.3	1.1
Durables	8.2	10.2	-1.1	0.1	1.5	1.3	2.3
Semi-durables	8.3	3.0	0.9	-0.2	-0.6	0.3	1.3
Non-durable goods	28.1	0.4	-0.7	-0.6	-0.8	0.0	0.8
Services	50.7	3.9	0.8	-1.3	0.2	0.3	1.2
Consumption by non-profit institutions	4.9	-0.1	-0.3	-0.9	0.0	0.5	1.0
Public consumption	100.0	-0.1	0.7	1.5	0.2	0.4	0.6
Central government	26.9	-4.1	-0.1	2.8	-0.5	-0.5	-0.5
Local government	66.1	1.6	1.0	1.1	0.3	0.9	0.9
Social security funds	7.0	0.9	0.4	0.3	1.7	-0.1	1.2
TOTAL		**2.0**	**0.3**	**0.0**	**0.1**	**0.3**	**0.9**
Individual consumption expenditure in general government		1.0	0.9	1.0	0.8	0.9	1.0
Total individual consumption expenditure		2.5	0.2	-0.3	0.2	0.4	1.1
Households´ disposable income		4.4	2.4	1.9	1.4	1.4	2.0
Private consumption deflator		3.2	3.0	2.6	1.3	1.4	1.4
Households´ real disposable income		1.2	-0.6	-0.6	0.0	0.0	0.6
	%						
Consumption as proportion of GDP (at current prices)		77.3	79.2	80.1	80.2	79.5	79.1
Household savings ratio		2.2	1.4	1.4	1.4	1.1	0.7
Household debt ratio [1)]		114.1	117.2	118.2	118.9	119.2	119.0

[1)] Household debt at end-year in relation to disposable income.

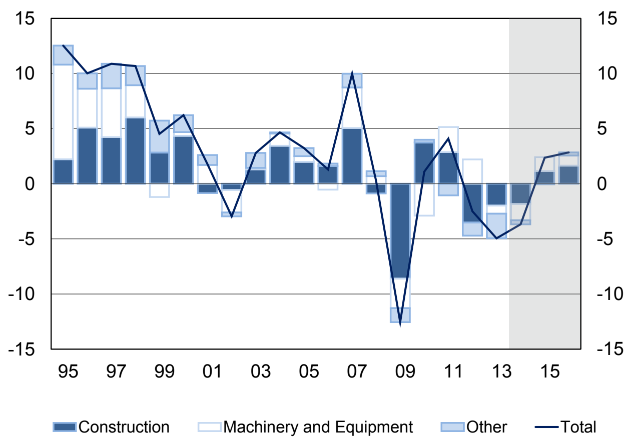
1.3.3 Private investment

Private investment growth slowly rebounding

It is projected that investment activity over the outlook period will be slightly more subdued than forecast in June. The downward revision of the forecast is in response to the most recent cyclical data and the July 2014 national accounts update and reform, which had the greatest impact on investment figures. According to the new national accounts gross investment in 2013 totalled EUR 42.6 billion, or almost EUR 6 billion more than in the old national accounts. In the new system research and development is treated as investment, even though the costs are comparable to spending on wages and salaries. Construction investment was also up as renovation activities are more comprehensively included. The national accounts reform increased investment rates by around one and a half percentage points. In 2014 the private investment to GDP ratio stands at 16.2%, almost one percentage point down from last year and the lowest figure ever in the history of national accounting. From 2015 the investment rate is expected to pick up again.

Despite the cyclical downturn the forecast projects that private investment will start growing towards the end of the current year, but the annual figure will still remain considerably lower than last year, around –4%. In Q1 2014 private investment fell fcompared to the last year at an annual rate of almost 7%. The decline in private investment will slower GDP growth this year by close to one percentage point. In 2015 and 2016 investment will drive economic growth by a total of almost one percentage point.

Investments
change in volume and growth impact, %



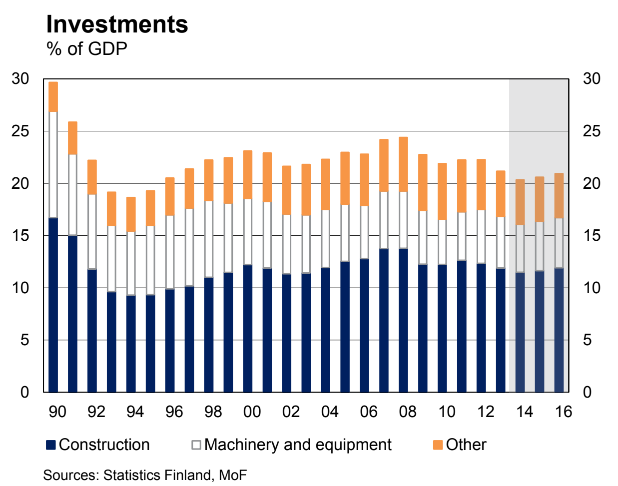
Sources: Statistics Finland, MoF

Housing investment hits rock bottom, but renovation on the up

New investment in housing is projected to decline by some 15% this year. Construction confidence indicators have long been seesawing, and the latest figures from July show a slight downward trend again. The rate of new housing starts is depressed by consumer caution, which has led to houses being on the market longer and to a dip in housing prices, especially outside the metropolitan Helsinki area. In the Helsinki area, prices have actually gone up slightly as housing funds have purchased large numbers of new housing units. According to the Confederation of Finnish Industries EK July Business Tendency Survey, the number of unsold housing units was slightly higher than usually, which also slowers new housing starts. This year the number of new housing starts will hit rock bottom and the estimate has been slightly revised downwards to just under 25,000 units. The 25-year average is some 30,000 new housing starts a year.

Surveys suggest that the climate of uncertainty is now spreading to affect renovation activities, too. Less than one-fifth or 18% of households are planning to spend on renovating their home within the next year. However, the forecast is that renovation will continue to develop steadily, as still this year the substantial government renovation grants remain in force. The number of hours worked in renovation have increased at the expense of new housing construction.

The decline in housing starts will bottom out in 2015 and housing investment will return to an annual growth rate of around 2–3% . Housing starts will accelerate in 2016 as low-rise housing construction gathers steam.



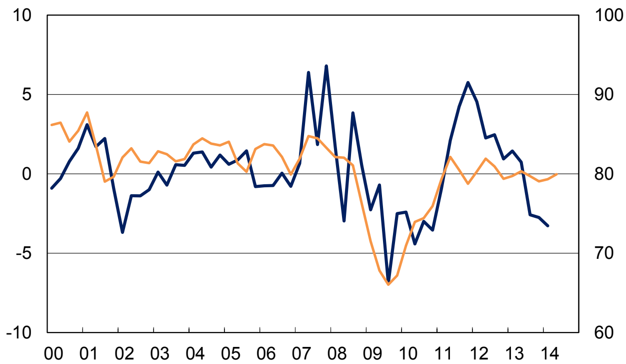
Private investment in other building construction remains subdued

The rate of non-residential housing starts was strong in the early part of the year, showing a first quarter increase of 8% compared to last year. This favourable trend can be attributed to school, hospital and other noncyclic projects as well as station construction projects. A large part of these are public construction projects, and the share of private construction is on the decline. In 2015–2016 investment in building construction will gradually pick up more widely as the acceleration of exports leads to new private production investments. One example is provided by the planned investment projects announced in the forest industry. Nonetheless the volume of building construction investment in the last year of the outlook period will still be slightly lower than in 2012.

Machinery, equipment and transport equipment set to rebound next year

Investment in machinery, equipment and transport equipment as well as investment in weapons systems, which are now included in the national accounts, fell sharply in the first quarter, but according to the EK June Investment Survey the value of fixed investment in 2014 is expected to increase by 2.7%. Hence, it is expected that investment in machinery and equipment will turn to clear growth towards the end of the year. This is supported by the statistic that in the first half of the year the number of new registrations in some categories of heavy duty transport equipment and machinery has shown double digit growth. Investment in machinery, equipment and transport equipment will continue on a solid growth track over the remainder of the outlook period.

Investment in machinery and equipment and capasity utilization rate



—Investment in machinery and equipment, change in moving annual total, %
—Capasity utilisation rate, industry, 6-month moving average, %

Source: Statistics Finland

Civil engineering sees brighter outlook

The outlook for civil engineering and land development investment is brighter than before, among other reasons as a result of the Government's stimulus efforts. The latest turnover and sales figures for civil engineering in the early part of the year are also encouraging. In its budget proposal the Government has suggested that some infrastructure investments be brought forward. Private civil engineering projects will also gradually increase as housing and non-residential building construction return to growth in 2016.

R&D: sharp downturn in recent years, slight upturn predicted from 2015

R&D expenditure increased sharply from the mid-1990s up to 2008, when its real value was more than 2.5 times higher than in 1995. This growth came to a halt in 2009, and in 2012 R&D spending fell by more than 7%.

In relative terms the most active innovators are large and international corporations. According to Statistics Finland's survey one-third of all companies operating in the domestic market reported product or process-related innovation activities, while the corresponding proportion among companies with international activities was 60%.

Central government R&D funding will also fall this year. In line with the national policy framework the single biggest category is the general promotion of science. The promotion of industrial production and technology will receive less than 20%.

It is projected that R&D spending will continue to fall this year and the ratio of research expenditure to GDP will also fall somewhat to 4.2%. In 2015 and 2016 it is anticipated that R&D spending will increase somewhat.

Table 8. Fixed investment by type of capital asset

	2013 share, %	2011	2012	2013	2014**	2015**	2016**
		Change in volume,%					
Buildings	46.7	6.4	-6.3	-4.8	-3.6	2.4	3.3
Residential buildings	28.9	5.3	-4.1	-2.2	-6.3	3.0	3.7
Non-residential buildings	17.8	7.9	-9.4	-8.9	0.7	1.6	2.7
Civil engineering construction	9.6	-1.0	-5.8	3.1	-1.5	0.1	1.0
Machinery and equipment	23.3	11.5	10.6	-3.2	-6.3	5.6	4.0
R&D-investments*	20.5	-4.3	-5.4	-10.4	-1.8	-0.2	1.4
Total	100.0	**4.1**	**-2.5**	**-4.9**	**-3.7**	**2.4**	**2.9**
Private	80.5	3.8	-3.3	-6.8	-4.6	2.9	3.5
Public	19.5	5.4	1.6	3.7	0.0	0.1	0.4
		%					
Investment to GDP ratio (at current prices)							
Fixed investment		22.2	22.3	21.2	20.3	20.6	20.9
Private		18.4	18.3	17.0	16.2	16.5	16.9
Public		3.8	4.0	4.1	4.1	4.1	4.0

* Includes cultivated assets and intellectual property products

1.3.4 Public investment

Central government accounts for less than half and the local government sector for just over half of total public investment. The national accounts reform meant that central government investment more than doubled as R&D expenditure is now treated as investment rather than current expenditure. Municipalities also have R&D investment. Likewise acquisitions of weapons systems are now treated as investment expenditure instead of current expenditure.

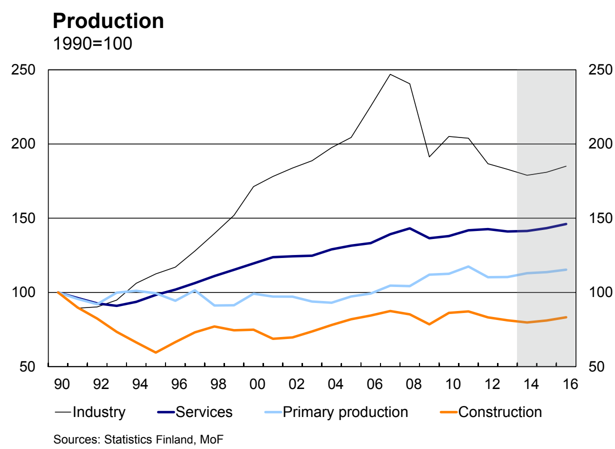
Public investment is expected to increase somewhat in the next few years with the roll-out of transport infrastructure and building renovation projects. The single biggest new project in the medium term is the Western Metro Extension, which is budgeted at some EUR 800 million. It is predicted that R&D investment will remain more or less unchanged.

1.4 Domestic production

1.4.1 Total output

Economic growth to remain subdued

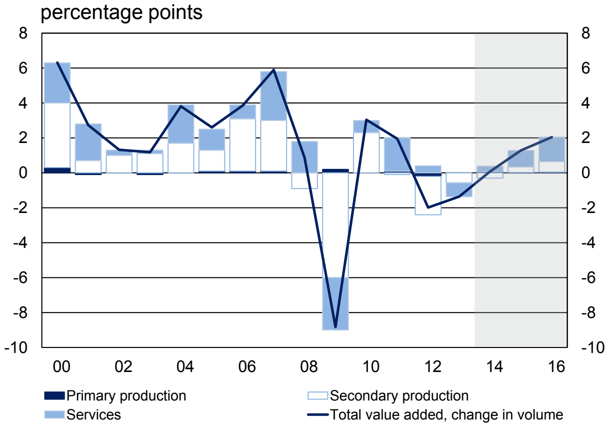
The Finnish economy is hovering on the brink of recession. GDP at market prices has decreased for two consecutive quarters meeting the technical definition of recession. Total value added, on the other hand, has decreased for only one quarter. On the other hand value added has not increased for two successive quarters either. This poor performance is explained first and foremost by two years of broadly based decline in service production, on both the private and public side. The picture is not much better for secondary production: for the past two years both industrial production and building construction have recorded growth only in occasional quarters. Primary production has shown stronger performance than other main sectors of the economy: this is the only sector where output is at a higher level than two years ago. In January-March output was unchanged from year-end 2013 as primary production recorded strong growth, service production was unchanged and secondary production declined sharply.



There are some signs of an imporvement during the spring. Early indications suggesting that output growth has turned positive. Technically speaking it seems that the economy has moved out of recession as total output increased marginally in the second quarter. However since the spring the outlook has once again taken a turn for the worse in the main sectors of the economy. Companies are suffering from a lack of demand both in industry, construction and services. On the other hand many of the companies that took part in the Business Tendency Survey reported no specific barriers to growth, particularly in industry and services. Slow demand is reducing the number of new orders, and businesses have to adjust their inventories to accommodate this decline. Existing order books therefore secure the continuation of production for a shorter period of time than earlier. The worsening mismatch problem in the labour market is reflected in an increasing shortage of skilled labour especially in the construction industry. In addition to the cyclical barriers to growth described above, the Finnish economy is hampered by structural changes that are causing capacity problems, especially in the forest and electronics industry.

Contribution to total production

percentage points

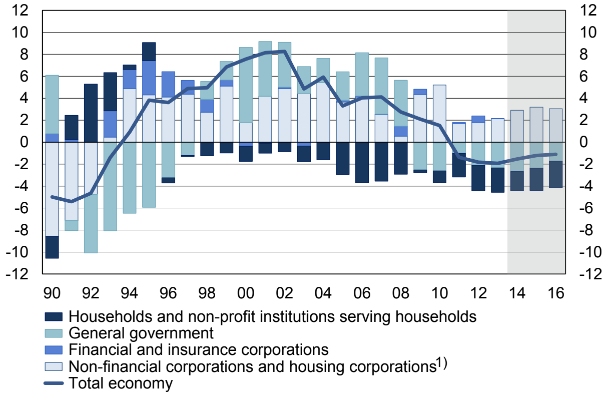


Sources: Statistics Finland, MoF

Poor performance in the first half of 2014 will weigh down on the figures for the whole year, and recovery will be a slow process. The improvement of output expectations is still subdued and unevenly distributed, but export-oriented industrial production and related services will certainly benefit from the gradual recovery of international demand. After the poor performance early in this year, output growth in 2014 is expected to come in at no more than 0.1%. In 2015 growth will be more broadly-based as output picks up in a larger number of branches, and output growth will climb to over one per cent. In 2016 growth is again broadly-based and is projected to reach 2%, even though output volumes will still be 4% lower than in the peak year 2008. Over the outlook period of just over two years, production to meet business demand will grow faster than production to meet consumer demand as sluggish household purchasing power will continue to hamper the growth of consumer demand.

Net lending by sector

% of GDP



1) Including financial sector in 2014-2016

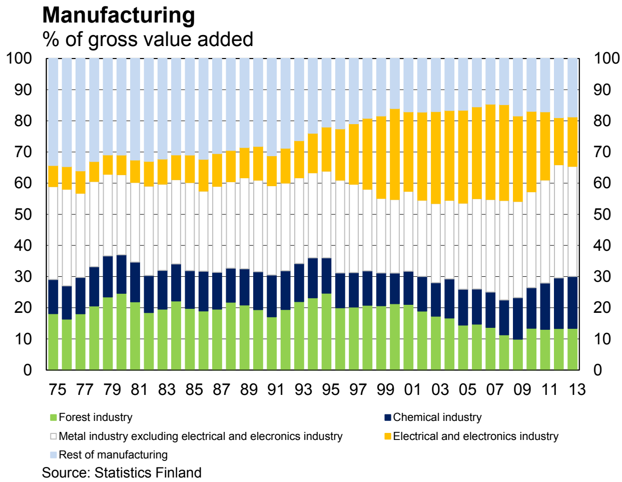
Sources: Statistics Finland, MoF

Over the outlook period the risks of future development are both in a weaker and stronger direction. On the one hand if the crisis in Ukraine persists, export demand may be affected more severely than forecast, in which case output in export industries would remain lower than predicted. On the other hand if the crisis is resolved sooner rather than later, export demand might pick up more strongly than forecast and therefore output would also increase more sharply than forecast.

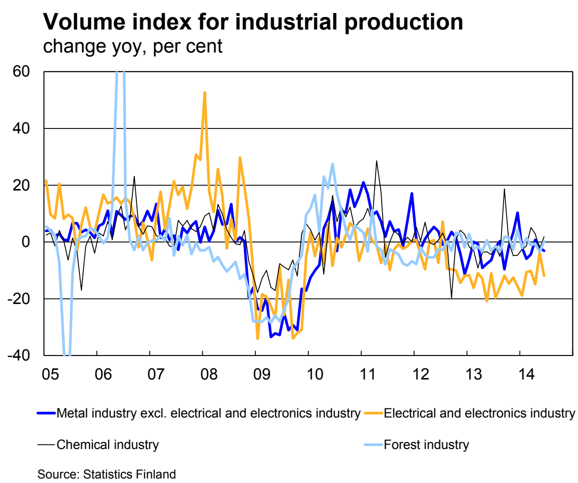
1.4.2 Secondary production

Industrial production faced by challenges

Industrial production currently accounts for an historically low share of one fifth of total output. In 2013 industrial production fell for the third year in succession, declining by 2%. The beginning of the current year was just as bad as the end of last year, with output falling sharply in January-March. The level of industrial production is more than one percent lower than in the beginning of 2013. This decline affected all main sectors of the economy, which posted poorer performance than in late 2013. Output performance was particularly weak in the electronics and electrical industry, the chemical industry and energy supply. Performance trends continued to remain sluggish in the spring, even though the rate of decline eased somewhat.



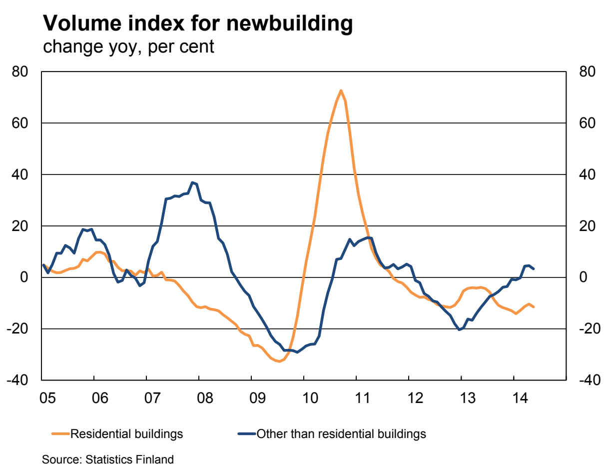
The outlook for industry is bleak. Export demand is weaker than before, competitiveness in many branches is poor and competition for markets is intense after a long downturn. The short-term outlook for businesses has shown no signs of improving since the spring, and output is expected to increase only marginally. The outlook is brightest in the technology industry, where order books improved early in the year. In other branches the short-term outlook is subdued and for the food industry very difficult due to Russia's counter-sanctions. Overall industry output is projected to fall by some 2% this year.



Despite the awaiting turnaround, the growth rate looks set to remain historically modest as the forest industry and electronics industry, formerly the powerhouses of the economy, have adjusted their production capacities in Finland. Furthermore it is expected that Finnish industry will have a reduced share of the growth in international demand, and therefore in 2015 manufacturing will increase by around 1% and in 2016 by no more than just over 2%. If this forecast is accurate, industrial output would still be one-quarter lower than before the financial crisis, while the number of hours worked in industry would be one-sixth lower than in 2008. In other words labour productivity would decline appreciably between 2009 and 2016, which is highly exceptional in the long term, especially in industry. Decline in electronics industry explains part of this weak productivity.

Foundation of construction slowly getting stronger

Value added in construction fell by 2.3% in 2013, for the second year in succession. Construction output continued to fall in January-March, but early statistics from the spring give reason to expect some improvement. The volume index of new building construction and the construction sales volume indicator show that construction output increased in March and April, although this increase was narrowly based and mainly driven by the construction of public service premises.



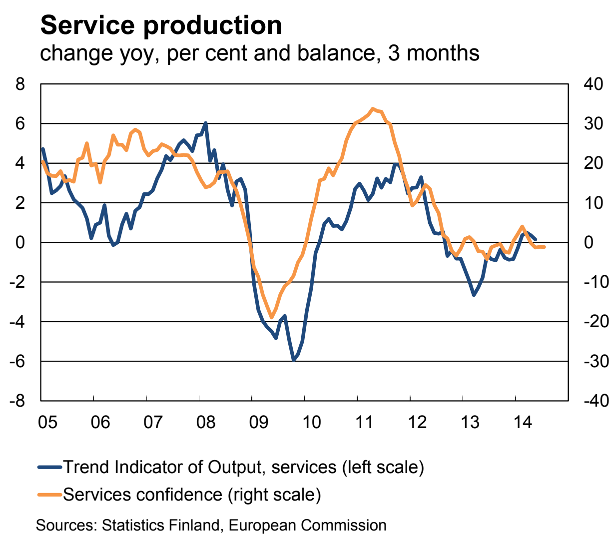
The outlook for construction output is bleak. The increase seen in the spring came only from a limited number of new construction projects, and the number of planning permissions granted turned back to a downward trend. Furthermore the Business Tendency Survey indicates that the construction outlook took a turn for the worse and output expectations fell during the summer. Among the perceived barriers to growth, companies reported less lack of demand, but more often mentioned the shortage of skilled labour. It seems then that labour market mismatch problems appear to have increased in the construction industry. As a result of the poor performance early in the year and the expected downturn in the remainder of the year, value added in construction will fall by close to 2% this year. Output will decline for the third year running.

If production capacity and investment in business and industry begin to recover as expected from 2015, value added in construction will return to a modest growth track and output will increase by over 1½%. It is expected that construction will only begin to return to a more solid growth track in 2016, when value added is expected to show growth of over 2½%. Even so, output would remain 5% lower than before the financial crisis. Renovation will sustain turnover in the construction sector throughout the outlook period.

1.4.3 Services

Production structure continued to shift towards services

The share of services in gross value added for the economy continued to increase in 2013 and now stands at over 70%, close to the euro area average of 73%. Nonetheless service production fell by 1.1% last year. Output declined in private service branches, but increased in public services. A fall in overall service production coupled with an increase in public service production is historically exceptional. Figures for public service production last increased in 2005. In January-March 2014 service production no longer declined, but nor did it increase.



The development of service production will continue to depend upon secondary production and consumption demand. Most services are used in the business sector, and therefore it will be necessary for business to rebound before service production can get back to more sustained growth. Business tendency surveys suggest that the outlook and expectations in services deteriorated in the summer, and therefore there is no immediate rebound on the horizon.

The outlook is weakest in trade sectors serving consumers and industry and transport sectors serving companies. Demand in the hotels and restaurants sector is also weaker than before. On the other hand turnover in information and communication services is rising strongly and sales expectations are continuing to improve. Output expectations are particularly weak in sectors serving private consumption as household purchasing power will remain weak both this year and next. Service production growth will remain subdued because of the recession in secondary production, reaching growth of no more than ½% this year. In 2015 the rebound of business activity will drive service production to growth of over 1% and in 2016 further to 2%. In contrast to other main sectors of the economy, service production in 2016 will exceed the levels recorded before the financial crisis.

Table 9. Production by industry

	2013* share, %[1]	2011	2012*	2013*	2014**	2015**	2016**	Average 2013/ 2003
		change in volume, %						
Industry	20.4	-0.6	-8.4	-2.0	-2.2	1.1	2.3	-0.3
Manufacturing	16.6	-0.1	-11.6	-1.9	-1.8	1.2	2.4	-0.7
Construction	6.5	1.2	-4.7	-2.3	-1.8	1.7	2.7	1.0
Agriculture and forestry	2.7	4.4	-6.2	0.2	2.2	0.7	1.4	1.6
Industry and construction	26.9	-0.2	-7.6	-2.1	-2.5	1.3	2.4	0.0
Services	70.5	2.8	0.5	-1.1	0.5	1.3	2.0	1.2
Total production at basic prices	100.0	2.0	-2.0	-1.4	0.1	1.3	2.0	0.9
GDP at market prices		2.6	-1.5	-1.2	0.0	1.2	1.4	1.1
Labour productivity in the whole economy		1.0	-2.1	0.6	0.6	0.7	1.2	0.7

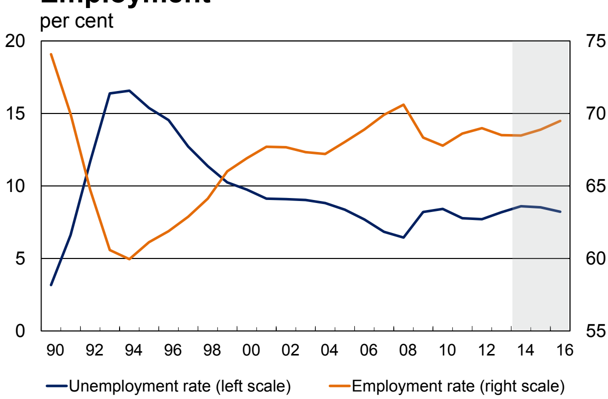
[1] Share of total value added at current prices.

1.5 Labour force

Employment situation continuing to deteriorate

The employment situation will continue to deteriorate this year. The number of persons employed in 2014 will be 0.4% lower than last year. If these projections materialise, the average annual number of persons employed this year will be the lowest since 2006. However the deterioration of the employment situation has steadily slowed since the end of last year, and it is predicted that the numbers employed will begin slowly to rise in 2015. On the other hand the rebound of economic growth has been slower than anticipated and will remain subdued throughout the outlook period. This sluggishness coupled with the structural problems in the economy undermine the prospects for a sustainable improvement in the employment situation over the next few years.

Employment



Unemployment rate = Unemployed / Labour force (15-74 yrs)
Employment rate = Employed / Population of working age (15-64 yrs)

Sources: Statistics Finland, MoF

According to Statistics Finland's Labour Force Survey unemployment has increased for the past two years, and it is projected to continue to increase in 2014. This year's projected unemployment rate is 8.6%. In recent years the number of unemployed job seekers registered with employment offices (Ministry of Employment and the Economy figures) has risen much more sharply than the unemployment figures indicated by Statistics Finland's sample-based Labour Force Survey, and indeed the gap between these two figures has grown to an historic high relative to the level of unemployment. The reason for this lies in both structural and cyclical factors. Although the two sets of unemployment figures are not directly comparable due to differences in methods and definitions, the widening gap between them suggests that ever fewer unemployment benefit recipients in Finland are actively seeking work.

In recent months the difference between the two sets of unemployment statistics has no longer grown as rapidly as before, and it is expected that it will begin to narrow over the outlook period as increasing numbers of unemployed job seekers registered with employment offices begin actively to search for work in the improving economic climate. This probably means that Statistics Finland's official unemployment figures will persist at a high level for some time to come, even if the number of registered job seekers started to fall as growth rebounds.

Although it seems that the worst of the deterioration in the employment situation is now over, signs of any real improvement are still fragile. Employment expectations continue to remain negative, and the number of job vacancies has increased only marginally. While the cyclical situation is cautiously improving, the structural problems are ever more apparent. Job vacancies are remaining unfilled for longer, and long-term unemployment has increased. The ongoing structural changes in the economy have led to clear compatibility problems between unemployed job applicants and job vacancies, both regionally and in specific occupational categories.

Apart from the labour market mismatch problems and the risk of marginalisation from the labour market, the challenge of increasing employment is set to become ever greater as a result of population ageing and the declining size of the labour force. All in all it is expected that over the next few years, employment growth will be very muted.

It is predicted that the employment situation will only begin to improve in 2015. However for the reasons just stated the number of persons employed will rise by no more than 0.3%. Even though production growth will be more broadly based in 2016, employment will continue to show only slow improvement, with the number of employed persons expected to increase by 0.6%. The same reasons that are deterring employment growth in the coming years are also contributing to the slow decline of unemployment. The unemployment rate will remain at over 8% throughout the outlook period.

Table 10. Labour market

	2011	2012	2013	2014**	2015**	2016**
	annual average, 1,000 persons					
Population of working age (15-74 yrs)	4 059	4 075	4 087	4 095	4 109	4 107
change	15	16	12	8	14	-1
Population of working age (15-64 yrs)	3 539	3 524	3 508	3 493	3 480	3 470
change	-16	-15	-16	-15	-13	-10
Employed (15-74 yrs)	2 474	2 483	2 457	2 447	2 454	2 468
of which 15-64 yrs	2 428	2 431	2 403	2 394	2 399	2 413
Unemployed (15-74 yrs)	209	207	219	231	229	221
	%					
Employment rate (15-64 yrs)	68.6	69.0	68.5	68.5	68.9	69.5
Unemployment rate (15-74 yrs)	7.8	7.7	8.2	8.6	8.5	8.2
	1,000 persons per annum					
Immigration, net	16.8	17.4	18.0	17.3	17.4	17.4

In the next few years ahead the employment situation will be significantly impacted by demographic trends, and therefore in order to gain an accurate picture it is useful to examine employment in relation to the population, i.e. the employment rate and labour participation rate. Looking at different age groups, the development of the employment rate in recent years has been weakest among people in the middle of their work career (25–54 yrs). For example, over the past three years (June 2011 – June 2014) the employment rate in this age group has fallen in all by 1.6 percentage points, at the same time as the employment rates in all other age groups have increased. This is a worrying trend as around 70% of all employed persons fall in this age bracket, and therefore increasing the employment rate in this group would be the best way to address the challenges related to funding the welfare state. Furthermore the weak employment trends in this age group are most pronounced at its youngest end, raising concerns about the permanent marginalisation of those young people who were made redundant or excluded from the labour market during the recession.

The situation looks much the same when viewed from the vantage-point of the labour participation rate. In the past three years the share of the labour force of the population has declined only in the age group 25–54, while in all other age groups the share has increased. There are no signs that this will be changing because in early 2014 both the employment rate and labour participation rate have developed least favourably among those in the middle of their work career.

1.6 Incomes, costs and prices

1.6.1 National income

Nominal net national income growth reached 0.8% last year, only marginally higher than the year before. In real terms net national income fell by 1.6%. Over the past three years the favourable trends in nominal net national income have been driven by the growth of employee compensations, while at the same time property income and entrepreneurial income have fallen.

Among the components of national income, employee compensations increased from the previous year by 0.6%. Wage bill growth slowed to 0.5%, and social security contributions paid for the benefit of employees increased by one per cent. Wage bill growth was clearly slowed by the deteriorating employment situation. Nonetheless in the last three quarters of 2013 wage bill growth reached an average of 0.7% compared to the year before. This was due to the one-off wage increase under the framework agreement in early 2012, which explains why the wage bill did not increase in Q1 2013 compared to the year before.

Employee compensations as a proportion of national income reached 62% last year and the year before, compared to the figure of around 60% in 2010 and 2011 and 56–57% in the early 2000s. The last time this figure was as high as this was during the 1990s recession, when it peaked at 74% in 1991. The reason why this percentage increased in 2012 and remained at the same level in 2013 lies in the relatively sharp rise in employee compensations and on the other hand in the lowered level of property and entrepreneurial income.

Table 11. Disposable income

	2013 share, %	2011	2012	2013	2014**	2015**	2016**	On average 2013/2003
		change, %						
Compensation of employees	61.9	4.8	3.6	0.6	1.2	1.7	2.3	3.6
Wages and salaries	50.1	4.6	3.4	0.5	0.9	1.7	2.2	3.8
Employers' contributions to social security schemes	11.8	5.6	4.1	1.0	2.5	1.9	2.7	3.0
Property and entrepreneurial income, net	21.8	-1.0	-9.4	-1.2	-1.0	4.1	4.3	-0.3
Taxes on production and imports minus subsidies	16.3	13.3	3.8	4.5	2.8	3.0	3.2	3.4
National income	100.0	4.5	0.4	0.8	1.0	2.4	2.9	2.5
Disposable income		4.6	0.5	0.3	2.7	2.4	2.9	2.5
Gross national income, EUR bn		197.7	200.1	201.9	204.6	209.9	216.1	

As a result of the sluggish economy, the operating surplus of Finnish companies fell by almost 10% in 2012. In 2013 operating surplus figures no longer declined as companies looked to improve profitability by cutting expenses. When property income to and from other countries are taken into account, property and entrepreneurial income fell in total by 1.2%. The amount of property income paid from foreign countries into Finland hardly increased at all last year, whereas property income paid out of Finland increased by more than 3%. In net terms payments into and out of Finland were close to balance. Taxes on production and imports net of subsidies increased by 4.5%, reflecting last year's increase in indirect taxes.

During the current year it is predicted that wage bill growth will pick up slightly from the previous year, despite a slowdown in earnings growth, because employment is not weakening at the same rate as in 2013. It is thought that social security contributions will rise more sharply than the wage bill because employer contributions were increased at the beginning of 2014 and agreed increases to earnings-related pension contributions will also tighten tax bases in 2015 and 2016. Wage bill growth will accelerate in 2015 and 2016 with the improving economy and strengthening employment, but still remain slower than the average rate for the 2000s. It is predicted that the share of employee compensations will fall only marginally towards the end of the outlook period, so there will be no major changes in the functional distribution of income over the next few years.

It is forecast that the operating surplus of businesses based in Finland will still fall in 2014, but pick up to show strong growth in 2015 and 2016 and so significantly accelerate national income growth. The acceleration of operating surplus growth is supported by the pick-up of economic activity, which will push businesses to try and improve their profitability and increase their profits. On the other hand taxes on production and imports net of subsidies will continue to rise over the outlook period with increasing indirect taxes in 2014 and 2015.

Table 12. Index of wage and salary earnings and labour costs per unit of output

	2011	2012	2013	2014**	2015**	2016**	On average 2013/2003
	change, %						
Index of negotiated wage rates	2.0	2.9	1.4	0.7	0.5	0.8	2.5
Wage drift, etc.	0.7	0.3	0.7	0.7	0.7	0.7	0.9
Index of wage and salary earnings	**2.7**	**3.2**	**2.2**	**1.4**	**1.2**	**1.5**	**3.4**
Real earnings[1)]	-0.7	0.4	0.7	0.3	-0.3	-0.3	1.6
Average earnings[2)]	3.3	3.3	2.0	1.4	1.1	1.4	3.4
Labour costs per unit of output[3)]							
whole economy	2.8	5.7	2.0	0.9	0.5	0.2	2.7

1) The index of wage and salary earnings divided by the consumer price index.

2) Computed by dividing the national wage bill by the number of hours worked by wage and salary earners. The figures are affected by structural changes in the economy.

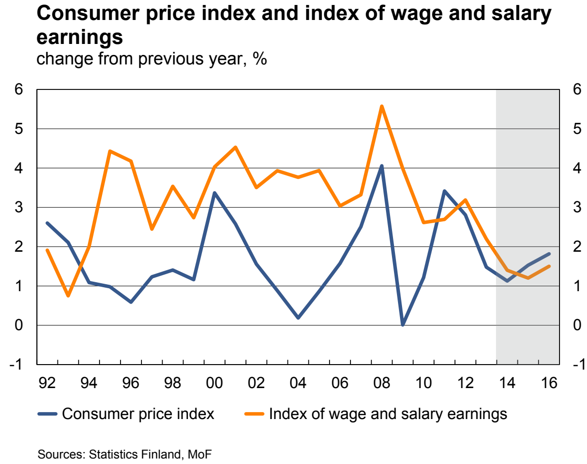
3) Compensation of employees divided by gross value added in volume at basic prices.

1.6.2 Wages and salaries

Nominal earnings, as measured by the index of wage and salary earnings, increased by 2.2% last year. Contractual wage increases were up by 1.4%, other factors pushed up the wage index by 0.8%. The contribution of other factors was higher than in previous years, edging up from an average of 0.5% in 2009–2012. In 2014 and 2015 earnings will develop in line with the new wage settlement agreed last autumn by the social partners. The Pact for Employment and Growth will in its first year push up collective wages by an average of 0.7%, and in the second year by around 0.5%. The forecast for the development of earnings works from the assumption that the contribution of factors other than collective wage increases will drive up earnings by over half a per cent in both years. Therefore it is predicted that nominal earnings will rise by 1.4% in 2014 and by 1.2% in 2015 as measured by the index of wage and salary earnings. This is well below the average of the 2000s, and well in line with the sluggish economy and slow employment trends. It is assumed that moderate earnings growth will continue in 2016, rising at a rate of 1.5%.

1.6.3 Consumer prices

Continued economic sluggishness early in the year has also been reflected in consumer prices. There has been only little upward price pressure from the international raw materials markets, and falling world market prices of food have finally begun to have an impact on the cost of the Finnish shopping basket. This year's price forecast has been slightly revised downwards, and the average projected inflation rate for 2014 is now 1.1%. Next year inflation is expected to come in at 1.5% and in the last year of the outlook period at 1.8%.



Several indirect taxes were again put up from the beginning of the year, and as expected these tax hikes fed into consumer prices. The tobacco tax hike, though, only showed up in the prices of tobacco prices from June onwards, as tobacco products were sold from existing stocks at the old tax rate until the end of May. It is estimated that the indirect tax hikes will put upward pressure of around 0.5 percentage points on the 2014 inflation rate.

Indirect taxes will continue to be increased in 2015 in order to boost central government finances and to steer consumption. Excise duties on energy products, tobacco and sweets will all be raised. In 2016 it is known that the annual vehicle tax will be increased, which will push up consumer prices by almost 0.5 percentage points. However according to currently available information the impact of the increase in the annual vehicle tax will, for tax technical reasons, be equally divided between 2015 and 2016. Taken together, these tax increases will exert upward pressure on consumer prices of some 0.5 percentage points in 2015 and some 0.3 percentage points in 2016.

Inflation curbed by the development of food prices

In the first half of 2014, consumer prices increased on average by 1.1% from the same period last year. In particular, prices of fresh foods – meat, fish, fruit and vegetables – have fallen considerably during the early part of the year. In May, average prices of fresh foods were more than 5% cheaper than in May 2013. However in June the decline in fresh food prices slowed to less than 3%. Inflation in processed foods (including tobacco and alcohol) has been steadier, averaging over 2% in the first half of the year. This year's crop outlook is good, and therefore it is anticipated that food world market prices will remain unchanged at their current level or even fall slightly.

Excise duty hikes from the beginning of the year had a significant impact on food prices. Tax changes on sugar-containing soft drinks, alcohol and tobacco products will accelerate average annual inflation this year by some 0.4 percentage points. It is estimated that the planned increase in the tobacco tax in 2015 will drive up consumer prices by around 0.1 percentage points. The impact of the planned tax hike on sweets and soft drinks is almost 0.1 percentage point. Otherwise it is thought that food prices in 2015 and 2016 will return close to their normal path.

Energy prices moderate

Consumer price trends are significantly impacted not only by food prices, but often also by fluctuations in energy prices. It is expected that the average price of crude oil this year will be lower than in 2013, and furthermore offered electricity rates fell considerably early in the year. Taxes on transport fuels and electricity were raised from the beginning of this year, creating upward price pressure of around 2%. It is estimated that the energy tax increases will push up the overall index by around 0.1 percentage point.

The energy tax hikes from the beginning of 2015 will drive up the consumer price index by around 0.15 percentage point. The single most significant increase is the electricity tax hike. Furthermore the tax on petrol, diesel and heating oil will be increased.

It is predicted that the euro-denominated world market price of oil will continue to fall slightly and that offered electricity prices will rise only slowly over the outlook period. Overall it is thought that over the next two years, moderate energy prices will significantly curb the rise in the consumer price index.

Service inflation slowing slightly

The consumer prices that have developed most steadily in recent history are the prices of goods and services. Overall goods prices have long been stagnant as home electronics prices have continued to fall. The contribution of goods prices to overall inflation has therefore remained quite marginal, and it is not thought there will be any significant change in this respect over the outlook period. Prices of services, by contrast, have risen at an annual average of 2.6% over the past ten years, and their contribution to inflation has been around one percentage point.

Labour costs are a significant expenditure in services, and therefore it is assumed that moderate wage trends over the outlook period will reduce pressures to increase service prices. However recent price trends have not yet shown any signs of slowing. For instance, rents have continued to rise steadily, prices of health services have increased sharply, and prices of mobile communications services have become considerably more expensive as the intense competition in this market has eased. The prevailing market situation can therefore have a significant impact on the prices of service goods.

Differences between national and EU indices due to owner-occupied housing

In 2014 Finnish consumer prices, as measured by the EU harmonised consumer price index, will still rise 0.2 percentage points faster than the national index. This difference is due to owner-occupied housing, which is included in the commodity basket for the national but not for the harmonised price index. The single biggest owner-occupied housing items are the mean interest rate on housing loans and the prices of houses and flats. In addition the national index includes the annual vehicle tax, gaming prices and interests on consumer loans.

Table 13. Price indices

	2011	2012	2013	2014**	2015**	2016**	On average 2013/2003
	change, %						
Export prices[1]	4.5	1.2	-0.8	-0.6	1.4	1.5	0.7
Import prices[1]	6.1	2.5	-1.1	-0.5	1.3	1.4	2.1
Consumer price index	3.4	2.8	1.5	1.1	1.5	1.8	1.8
Harmonized index of consumer prices	3.3	3.2	2.2	1.3	1.3	1.4	2.0
Basic price index for domestic supply	6.4	3.1	0.2	-0.7	1.3	2.1	2.9
Building cost index	3.3	2.4	1.0	0.9	1.5	2.4	2.6

[1] As calculated in the National Accounts.

The forecast is that the situation will be reversed in 2015–2016 as prices for commodities included only in the national index are predicted to rise more sharply than the harmonised index. The reason for this is that reference interest rates will start rising with the improving economic situation. However it is projected that this rise will not be as sharp as previously thought. Another major factor is the substantial increase in the annual vehicle tax, which on average will rise by some 35%.

Finnish inflation to remain higher than euro area inflation in 2014

Measured by the EU harmonised consumer price index, inflation in Finland has in recent years exceeded the average euro area rate. This is explained, on the one hand, by increases in indirect taxes and, on the other hand, by the persistently higher rate of inflation in services, and rents in particular, when compared to the euro area, not only in the crisis countries but also in Germany. Finnish inflation will continue to remain higher than in the euro area in 2014: the Economic Department's forecast for Finland's harmonised inflation is 1.3% and the European Commission's spring forecast for euro area inflation is 0.8%.

Next year it is predicted that the difference will narrow as the Economic Department's forecast for Finland's harmonised inflation remains unchanged at 1.3%, while the European Commission's spring forecast predicts an acceleration of euro area inflation to 1.2%. At the end of the outlook period it is expected that Finnish inflation, measured by the EU harmonised consumer price index, will remain at a moderate 1.4%.

2 Economic policy and public finances

2.1 General government finances

General government finances have been in deficit for the past five years. In 2013 the deficit came in at EUR 4.7 billion, or 2.3 % of GDP. The deficit is the result of persistent cyclical weakness, but adjustment measures have helped to curb its growth. General government's fiscal position is also exacerbated by expenditure growth resulting from population ageing.

General government in Finland consists of central government, local government and social security funds, which consist of earnings-related pension funds that manage statutory earnings-related pension insurance and other social security funds. The general government sector that is most vulnerable to cyclical fluctuations is central government, particularly because of the high cyclical sensitivity of tax revenue.

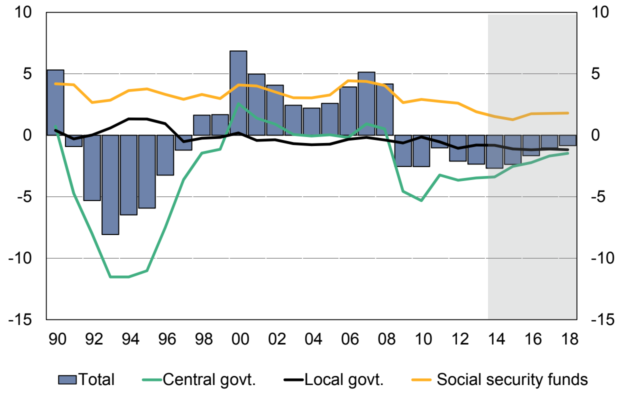
Central government is in deep deficit. As the economy has been shrinking for two years in succession, even vigorous adjustment has not helped to significantly reduce the deficit. However over the outlook period the deficit will shrink somewhat in response to adjustment efforts and rebounding economic growth.

Local government finances showed a deficit of EUR 1.6 billion in 2013. The balance in local government finances was boosted by a sharp rise in tax revenue, mainly driven by one-off factors, and by local authorities' adjustment efforts. Over the outlook period local government finances will be adversely affected by weak tax revenue growth, cuts in central government transfers to local government, population ageing and the consequent increase in demand for social and health care services. It is projected that local government finances will remain firmly in deficit over the next few years.

Earnings-related pension institutions are the only general government sector that is firmly in surplus. However that surplus is set to decline over the outlook period. The financial position of authorised pension providers is undermined by rising pension expenditure. Insurance contribution rates will be increased in order to maintain an adequate level of prefunding in the earnings-related pension system. Other social security funds are expected to remain close to balance over the outlook period.

The financial balance of general government subsectors

% of GDP

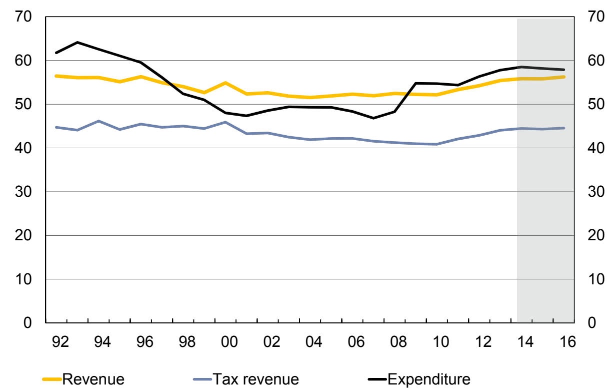


Sources: Statistics Finland, MoF

The expenditure rate, i.e. the ratio of general government expenditure to GDP, increased by 1.5 percentage points to almost 58% in 2013. The expenditure rate has risen significantly in recent years. The growth of age-related expenditure is driving up the expenditure rate, but on the other hand adjustment measures are contributing to slow it down. In the medium term the expenditure rate will fall slightly, i.e. expenditure will increase at a slightly slower rate than output. The tax rate, i.e. the ratio of taxes and social security contributions to output, increased by one percentage point last year. The tax rate was increased by multiple tax hikes. In the years ahead the tax rate will average around 44.5%.

General government revenue, tax revenue and expenditure

% of GDP



Sources: Statistics Finland, MoF

The EU Stability and Growth Pact requires that the general government deficit must not exceed 3% and the general government debt-to-GDP ratio must not be higher than 60%. Finland has met these criteria even under the conditions of persistent cyclical weakness. In the medium term, too, Finland will continue to satisfy the SGP criteria for general government deficit. However the public debt ratio will exceed the 60% reference value. The stock of public debt has been increased not only by central and local government deficits, but also by solidarity operations to support other euro area countries. Reviews of any breaches of the GDP reference value will consider the impact not only of these operations, but also that of adverse cyclical conditions.

The SGP furthermore requires that each Member State specify a medium-term objective (MTO) for general government structural balance. The MTO is intended to ensure that there is a sufficient safety margin to the 3% deficit limit, to secure the sustainability of general government finances, and to allow room for budgetary manoeuvre for public investment, for instance. In March 2013 Finland set itself the medium-term objective of a 0.5% structural deficit. In 2014–2016 Finland will fall well short of this objective.

Public finances in the ESA reform

The European Union has agreed to adopt a new national accounting system (ESA 2010) from the end of September 2014. Statistics Finland published the revised national accounts figures for Finland on 11 July 2014.

Under the new accounting standards Finland's GDP value is 4% higher than earlier. This is primarily due to the way that R&D is treated in the new accounting system: R&D expenditure is now defined as capitalisation, i.e. an investment item rather than a current expenditure item. The annual change in GDP volume changed only marginally. In connection with the ESA 2010 time series adjustments, some other revisions were also made to the national accounts figures.

Perhaps the single most noteworthy change is the redefinition of the concept of general government balance. The definition used so far in connection with stability programmes, the excessive deficit procedure and in other EU contexts has been the EDP deficit , which differs from the national accounts definition of fiscal balance in its treatment of net interest payments.

Cash flows under swap and forward rate agreements, which in EU contexts are entered under interests, are treated in the national accounts as financial transactions related to derivatives. In recent years these agreements have been very popular in Finland, and they have significantly reduced Finland's general government deficit in EU contexts. For this reason Finland's budget balance to GDP ratio, the main focus of EU monitoring, will decline by around 0.3 percentage points.

Otherwise the ESA reform has had no noteworthy impact on the general government budgetary position. It has, however, increased the figures for general government euro-denominated revenue and expenditure as well as public debt.

The definition of general government sectors was revised in connection with the reform so that units primarily serving general government were transferred from corporations and the non-profit sector to general government. Senate Properties and universities' property companies, all of which carry debt, were transferred to central government. Some 150 new units, including universities of applied science and property companies, were transferred to the local government sector.

The redefinition of sectoral boundaries increased the amount of public debt. Statistics Finland will publish the revised debt figures in late September: only then will we know the exact impact of the reform on public debt. The forecast assumes that the new debt figure is EUR 2.4 billion higher than the old national accounts debt in 2011–2013. However the public debt to GDP ratio will fall because of the higher GDP value. Likewise general government revenue and expenditure to GDP, i.e. the revenue and expenditure rate fell because of the increased GDP level.

Under ESA 2010 R&D expenditure is entered as investment rather than intermediate consumption. This increased both central government and local government investment expenditure, and therefore at once general government overall expenditure. Likewise acquisitions of weapons systems are now treated as investment expenditure instead of intermediate consumption. This also increased the level of central government investment, which more than doubled compared to the old national accounts.

The capitalisation of R&D expenditure increased revenue and expenditure to the same extent and had no impact on the balance. Central government and local government revenue increased as a result of the increase in output for own final use by the amount equivalent to the capitalisation of R&D expenditure.

Under ESA 2010 the EU contribution based on the VAT base is entered as central government tax revenue and at once as a central government transfer to the EU, while previously it was entered directly as EU-levied VAT. This increased central government tax revenue as well as central government transfers. The transfer of municipally-owned universities of applied science companies to the local government sector increased the amount of central government transfers received by local government and accordingly reduced the amount of central government transfers to non-profit institutions.

Other revisions than those directly related to the ESA 2010 reform included changes to the treatment of local government VAT refunds: these changes increased central government VAT revenue and increased the amount of central government transfers to local government accordingly. More detailed information was made available about occupational health compensations paid out by Kela to local governments: this slightly improved the financial position of municipalities. Likewise with access to more detailed information on the payment of the annual vehicle tax, an increased portion of this tax is now treated as a tax paid by households.

Table 14. General government finances [1)]

	2011	2012*	2013*	2014**	2015**	2016**
	EUR billion					
Current taxes	31.2	31.2	32.9	33.5	34.1	35.5
Taxes on production and imports	27.2	28.1	29.2	29.9	30.7	31.4
Social security contributions	24.0	25.5	25.9	26.7	27.5	28.4
Taxes and contributions, total [2)]	82.8	85.4	88.7	90.7	92.8	95.9
Other revenue [3)]	22.6	23.1	23.6	23.7	24.6	25.8
of which interest receipts	2.8	2.5	2.5	2.2	2.4	2.5
Total revenue	**105.0**	**107.9**	**111.6**	**113.9**	**116.8**	**121.1**
Consumption expenditure	46.5	48.7	50.2	51.1	52.0	53.2
Subsidies	2.7	2.7	2.7	2.9	2.8	2.7
Social security benefits and allowances	33.9	36.1	38.4	40.3	41.3	42.6
Other current transfers	5.5	5.6	5.9	5.7	5.7	5.9
Subsidies and current transfers, total	42.1	44.4	47.0	48.8	49.9	51.2
Capital expenditure [4)]	8.2	8.5	8.8	8.9	9.0	9.2
Other expenditure	10.3	10.6	10.3	10.6	10.8	11.3
of which interest expenses	2.7	2.8	2.5	2.6	2.6	2.8
Total expenditure	**107.0**	**112.1**	**116.3**	**119.4**	**121.8**	**124.8**
Net lending (+) / net borrowing (-)	**-2.0**	**-4.2**	**-4.7**	**-5.5**	**-4.9**	**-3.7**
Central government	-6.4	-7.3	-7.0	-6.9	-5.4	-5.0
Local government	-1.1	-2.1	-1.6	-1.7	-2.2	-2.5
Employment pension schemes	5.4	4.8	3.8	3.5	3.1	3.9
Other social security funds	0.0	0.4	0.0	-0.4	-0.5	-0.1
Primary balance [5)]	-1.9	-3.7	-4.6	-5.0	-4.6	-3.4

[1)] As calculated in the national accounts, ESA95.

[2)] Incl. capital taxes.

[3)] Incl. capital transfers and consumption of fixed capital.

[4)] Gross fixed capital formation and capital transfers.

[5)] Net lending before net interest expenses.

Table 15. Main economic indicators in general government

	2011	2012*	2013*	2014**	2015**	2016**
	% of GDP					
Taxes and social security contributions	42.1	42.9	44.0	44.4	44.3	44.5
General government expenditure [1]	54.4	56.3	57.8	58.5	58.2	57.9
Net lending	**-1.0**	**-2.1**	**-2.3**	**-2.7**	**-2.4**	**-1.7**
Central government	-3.2	-3.7	-3.5	-3.4	-2.6	-2.3
Local government	-0.5	-1.1	-0.8	-0.8	-1.1	-1.1
Employment pension institutions	2.7	2.4	1.9	1.7	1.5	1.8
Other social security funds	0.0	0.2	0.0	-0.2	-0.2	0.0
Primary balance [2]	-1.0	-1.9	-2.3	-2.4	-2.2	-1.6
General government debt [3]	**48.5**	**53.0**	**55.9**	**59.6**	**61.2**	**62.1**
Central government debt	40.5	42.2	44.6	47.6	48.5	49.0
General government employment. 1000 person	629	630	633	629	627	626
Central government	141	139	142	140	138	136
Local government	477	480	480	479	479	479
Social security funds	11	11	11	11	11	11

[1] EU-harmonized definition.

[2] Net lending before net interest expenses.

[3] Public debt is estimate by the Ministry of Finance also for years 2011, 2012 and 2013 due to the statistics revision. See box on page 70.

Table 16. Fiscal balance and debt ratios in some EU economies

	2013*	2014**	2015**	2013*	2014**	2015**
	Fiscal balance			Debt		
	% of GDP					
Finland	-2.1	-2.3	-1.3	57.0	59.9	61.2
United Kingdom	-5.8	-5.1	-4.1	90.6	91.8	92.7
Sweden	-1.1	-1.8	-0.8	40.6	41.6	40.4
Denmark	-0.8	-1.2	-2.7	44.5	43.5	44.9
Ireland	-7.2	-4.8	-4.2	123.7	121.0	120.4
Spain	-7.1	-5.6	-6.1	93.9	100.2	103.8
Netherlands	-2.5	-2.8	-1.8	73.5	73.8	73.4
Luxembourg	0.1	-0.2	-1.4	23.1	23.4	25.5
Portugal	-4.9	-4.0	-2.5	129.0	126.7	124.8
Austria	-1.5	-2.8	-1.5	74.5	80.3	79.2
Germany	0.0	0.0	-0.1	78.4	74.0	73.6
France	-4.3	-3.9	-3.4	93.5	95.4	96.6
Belgium	-2.6	-2.6	-2.8	101.5	101.7	101.5
Italy	-3.0	-2.6	-2.2	132.6	135.2	133.9
Greece	-12.7	-1.6	-1.0	175.1	177.2	172.4

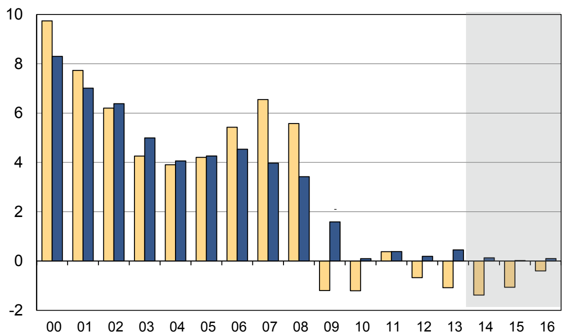
Source: EU Commission forecast spring 2014.

2.1.1 Estimates of fiscal policy impact

In 2014 the fiscal policy stance at general government level will be slightly restrictive. As regards central government, tax base changes will contribute to ease taxation somewhat. On the other hand increases to pension contributions and municipal taxes will have the effect of driving up the tax rate in 2014. The adjustment measures adopted by the Government will tighten central government fiscal policy in 2015 by some EUR 3 billion, and pension contributions will increase by 0.4 percentage points. The tax rate will rise only moderately over the outlook period as the most important tax bases such as the wage bill and private consumption will increase more slowly than output in 2014–2016. The expenditure rate will still increase in 2014, but start falling in 2015 in response to savings measures and reduced cyclical expenditure.

An examination based on changes in the structural primary balance does not give exactly the same picture of fiscal policy stance as an examination derived from individual revenue and expenditure measures. It is forecast that the structural balance will deteriorate somewhat in 2014, but remain slightly in surplus over the outlook period. In 2015–2018 the structural primary balance will improve less than might be anticipated based on individual measures. Changes in the structural primary balance are not necessarily indicative of a discretionary fiscal policy as the changing population age structure is driving up public expenditure. Age-related social and health care expenditure will increase even without separate decisions and therefore adversely affect the structural primary balance if fiscal policy otherwise is neutral. Fiscal policy only becomes contractionary when adjustment measures exceed the deterioration resulting from population ageing. The estimate of the structural primary balance is subject to considerable uncertainty: this is due to uncertainties in output gap calculation and annual fluctuations in revenue and expenditure elasticities estimated for the output gap.

Primary balance and cyclically adjusted primary balance [1)]
% of GDP



General government primary balance [2)]

General government cyclically adjusted primary balance

1) Based on the European Commission's production function approach.

2) Primary balance before grossinterest expenses.

Sources: Statistics Finland, MoF

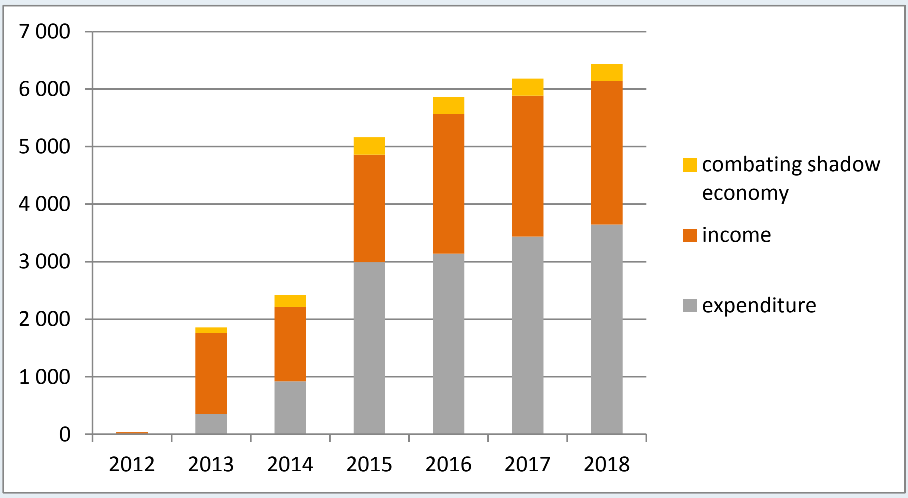
Adjustment measures during electoral term

During the 2012–2015 spending limits period the Government has each spring taken savings decisions in connection with its spending limits discussions. In the current electoral term the expenditure cuts and revenue increasing measures will strengthen central government finances by a net total of EUR 5.2 billion, or 2.5% of GDP at an annual level in 2015 when compared to the last spending limits decision of the previous electoral term. At an annual level in 2018 the net effect of the adjustment measures rise to EUR 6.4 billion, or 2.8% of GDP.

The adjustment measures at general government level exceed their value at central government level primarily because of increases in social security contributions. At general government level the net effect of the adjustment measures at an annual level in 2018 is around EUR 7.5 billion, or 3.3% of GDP.

It is important to note that in connection with the spring 2014 general government fiscal plan the decision was made to allocate central government assets to more productive use. State assets will be sold and transfers from certain funds to central government will be increased. This will bring extra revenue of EUR 1.9 billion to central government in 2014–2015. Most of this will be used to pay off central government debt but money will also be spent on know-how and innovation investment as well as transport and construction projects with immediate employment effects: in 2014–2015 the value of these investments will come to EUR 460 million. These one-off revenue recognitions and temporary additional expenditures are not reflected in the figures describing the scale of the adjustment measures.

Figure 1. Adjustment measures in central government sector, net, EUR million



Adjustment measures at general government level, net, EUR billion

	2013	2014	2015	2016	2017	2018
Measures affecting central government tax revenue	1.4	1.3	1.9	2.4	2.4	2.5
Savings in central government appropriations	0.4	0.9	3.0	3.1	3.4	3.6
Presumed revenue from grey economy prevention	0.1	0.2	0.3	0.3	0.3	0.3
Central government adjustment measures total	**1.9**	**2.4**	**5.2**	**5.9**	**6.2**	**6.4**
Increases to social security contributions	0.6	1.2	1.4	1.8	2.0	2.1
Cuts in central government transfers to local government	-0.8	-1.0	-1.3	-1.3	-1.4	-1.4
Other items	0.4	0.6	0.6	0.4	0.4	0.4
General government adjustment measures total	**2.0**	**3.2**	**5.9**	**6.7**	**7.1**	**7.5**

Permanent central government expenditure savings

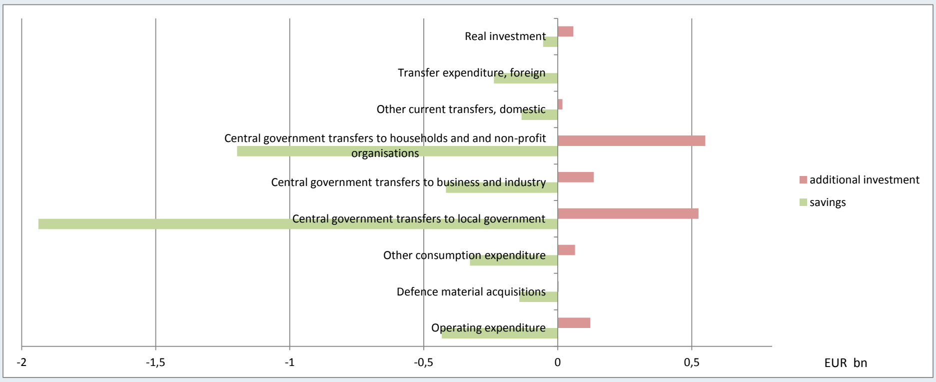
Expenditure cuts will increase in 2015, reducing central government expenditure by a net total of around EUR 2 billion compared to savings in 2014. Net savings in 2015 appropriations amount to some EUR 3 billion when compared to the last spending limits decision of the previous electoral term. Discounting the additional investment decisions taken by the Government, gross savings at an annual level in 2015 come to approx. EUR 4.7 billion.

The 2015 expenditure cuts are broadly based, affecting several administrative branches, and they are based on the earlier savings decisions mentioned above. In 2015 central government savings will be further increased from the previous year among others in

— central government transfers to local governments for the provision of basic public services,
— development cooperation expenditure,
— child allowances,
— Defence Forces operating expenditure and materiel acquisitions,
— expenses under the Sickness Insurance Act,
— national support for agriculture and horticulture,
— public labour and enterprise services,
— unemployment security expenditure,
— central government operating expenditure, and
— crisis management expenditure.

On the other hand, the Government has decided to allocate additional funding to implement the young people's social guarantee scheme, to further strengthen unemployment security and basic income security, support the development of social and health care services, including the Act on Care Services for the Elderly, develop the transport infrastructure, support renewable energy production and combat the grey economy.

Figure 2. On-budget expenditure savings and additional investments at 2015 level



Changes to tax bases

Tax base changes in 2015 will increase central government's net tax revenue by EUR 0.6 [1] billion compared to 2014. Overall the effect of the tax base changes will come to around EUR 1.9 billion at 2015 level compared to the last spending limits decision of the previous electoral term. This figure ignores the revenue from the YLE tax [2], but the non-adjustment of income levels in earned income taxation in 2013 and partly in 2014 [3] is included as a factor increasing tax revenue.

The most significant tax changes have included the increase of VAT rates across the board in 2013 (approx. EUR 0.8 billion at 2015 level), the non-adjustment of income levels in earned income taxation in 2013 and partly in 2014 (approx. EUR 0.3 billion at 2015 level), and the reduction of the corporate tax rate in 2014 (approx. EUR -0.9 billion at 2015 level).

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1 Including tax revenue estimated at EUR 300 million (at 2015 level) from the prevention of the grey economy. The figures take account of the timing factors related to the accrual of tax revenue changes. In an annual comparison 2015 tax revenue will increase by EUR 0.3 billion from 2014.

2 The YLE tax will increase tax revenue, but that revenue will be transferred to the public service broadcasting company YLE as an appropriation on the expenditure side of the budget. Therefore the tax is not included among adjustment measures.

3 This is not a tax base change, but it does increase tax revenue.

2.1.2 General government debt

Statistics Finland will release the general government debt figures based on the new national accounting standards in late September 2014. For this reason all the general government debt figures given here are MoF estimates. In any event it is clear that the amount of public debt will be higher than before as the new definition of general government includes new units with debt commitments. The forecast assumes that general government debt in 2011–2014 is EUR 2.4 billion higher than the figures based on the old national accounts, i.e. 2.6% higher than the old debt figure. At the same time, however, the public debt to GDP ratio will be down by some 0.8 percentage points as GDP figures will be around 4% higher than before the national accounts reform.

General government debt increased by an estimated EUR 7 billion last year to EUR 110 billion, or around 56% of GDP. General government debt will continue to increase over the medium term, and exceed the 60% threshold by next year at the latest. It is forecast that the debt-to-GDP ratio will continue to rise in the years ahead.

The general government debt forecast is based on central government's net borrowing needs and on the central government debt forecast derived from those figures. In addition the forecast takes account not only of on-budget debt, but also the debt accrued by units that in the national accounts are included in central government. Among these units the highest levels of debt are recorded for Senate Properties and universities' property companies. The general government debt figure is also impacted by local government deficits and the need for borrowing in local government. Social security funds effectively have no debt at all.

General government debt also includes some other items, such as loans granted by the European Financial Stability Facility (EFSF) to recipient countries, security deposits related to government derivative contracts, debts related to public–private partnership projects, the capital assets of the State Nuclear Waste Management Fund and coins in circulation. By the end of August 2014 Finland's public debt was listed as including EUR 3.5 billion in EFSF loans to crisis countries.

Table 17. Change in general government debt ratio and related factors

	2012*	2013**	2014**	2015**	2016**	2017**	2018**
Debt ratio. % of GDP [1]	53.0	55.9	59.6	61.2	62.1	62.4	62.6
Change in debt ratio	4.5	2.9	3.7	1.6	0.9	0.3	0.2
Factors impacting change in debt ratio							
Primary budgetary position	0.7	1.1	1.4	1.1	0.5	-0.2	-0.6
Interest expenditure	1.4	1.3	1.3	1.3	1.3	1.3	1.5
Change in GDP volume	0.8	0.7	0.0	-0.7	-0.9	-0.9	-0.9
Change in GDP price	-1.4	-1.3	-0.8	-0.9	-1.0	-1.1	-1.2
Acquisition of financial assets (net)	2.4	1.9	1.7	1.5	1.8	1.8	1.8
Other factors [2]	0.6	-0.7	0.1	-0.7	-0.8	-0.6	-0.4

[1] Public debt is estimate by the Ministry of Finance also for years 2011, 2012 and 2013 due to the statistics revision. See box on page 70.

[2] Includes privatization proceeds. lending and factors related to the valuation and timing of revenue and expenditure.

Plus indicates increasing effect on debt ratio. minus a lowering effect on debt ratio.

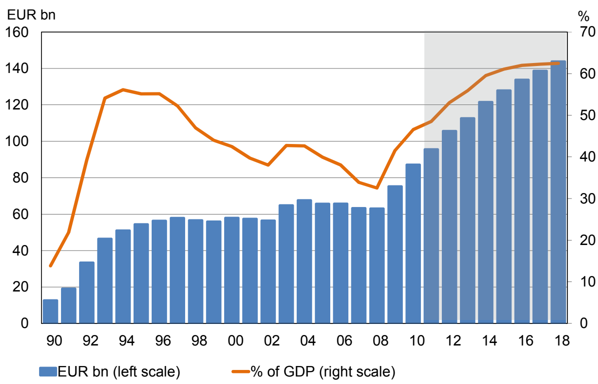
The general government debt-to-GDP ratio increased by 2.9 percentage points in 2013. The Table below provides an overview of general government debt dynamics. It illustrates the relationship between the general government budgetary position and debt ratio change in the national accounts. A plus sign indicates that the factor has the effect of increasing the debt ratio, a minus sign that it decreases the debt ratio.

The general government primary balance showed a deficit last year, driving the growth of debt by 1.1 percentage points. Interest payments accounted for 1.3 percentage points of the increase in the debt ratio. When the level of debt is compared to GDP, GDP growth has the effect of lowering the debt ratio. In 2013 the fall in GDP volume slightly increased the debt ratio, but the GDP price change lowered it by 1.3 percentage points.

The Finnish definition of general government as comprising earnings-related pension funds has a major impact on how the annual general government budgetary position is reflected in changes in general government debt. Earnings-related pension funds show a surplus. In 2013 that surplus was 1.9% of GDP ("Acquisition of financial assets (net)"). Since the surplus of earnings-related pension funds is included in the primary budgetary position of general government, but it is not used to pay off general government debt, this surplus must be excluded from the range of factors impacting the change of debt ratio.

In addition to these factors, central government lending and factors related to the valuation and timing of revenue and expenditure decreased the general government debt ratio by 0.8 percentage points in 2013.

General government debt



Sources: Statistics Finland, MoF

2.2 Central government

Central government finances have been in deep deficit for five years in succession. In 2013 the central government national accounts deficit stood at EUR 7 billion. Despite the fall in GDP last year, the deficit decreased by EUR 0.3 billion. A succession of tax hikes meant that revenues increased more rapidly than expenditure. Tax revenue increased most notably as a result of the increase in all VAT rates and the introduction of the bank tax. It is estimated that the central government budgetary position will remain in deficit throughout the outlook period.

The national accounts reform increased both central government revenue and expenditure by some EUR 2 billion, but the financial balance figures changed only slightly. The increased revenue and expenditure figures were mainly due to the capitalisation of R&D expenditure, the new method of entering VAT payments to the EU and changes in local government VAT refunds. In addition some private sector units were transferred to the state sector.

The economy will deliver no growth even in the current year, and therefore the prospects for the central government deficit shrinking are poor. The deficit will remain unchanged as both revenues and expenditure are set to increase by around one per cent.

In 2015 the impacts of adjustment will begin to take hold on both the revenue and expenditure side and the central government deficit will shrink. Although still sluggish, the slow rebound of the economy will accelerate the growth of tax revenue and the central government deficit will shrink by more than EUR 1.5 billion.

It is predicted that the central government deficit will shrink each year over the medium term on the back of economic growth and continuing adjustment measures. In 2018 it is forecast that the deficit will reach some EUR 3.5 billion, or 1.5% of GDP.

Central government debt will grow throughout the outlook period, although this growth will slow in the next few years. In 2018 central government debt will stand at EUR 112 billion. The central government debt-to-GDP ratio will level out in the medium term.

The amount of Government issued guarantees has increased in recent years. These guarantees are not an expenditure item and do not show up in the State Budget. At the end of Q1 2014 the stock of state loan guarantees amounted to EUR 34.3 billion, 12% higher than the figure one year earlier. State guarantees include all guarantees issued by central government, state enterprises, state-owned joint stock companies and special credit institutions ultimately backed by central government.

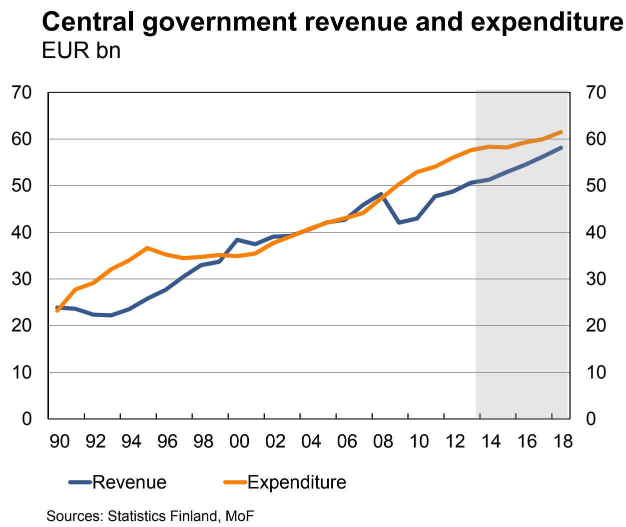


Table 18. Central government [1)]

	2011	2012*	2013*	2014**	2015**	2016**
	EUR billion					
Current taxes	12.1	11.8	12.2	12.3	12.5	13.4
Taxes on production and imports	27.2	28.1	29.2	29.9	30.7	31.4
Taxes and contributions, total [2)]	39.6	40.5	42.1	42.8	43.7	45.4
Other revenue [3)]	8.2	8.5	8.9	8.9	9.5	9.2
of which interest receipts	0.5	0.5	0.4	0.4	0.4	0.5
Total revenue	**47.8**	**49.0**	**51.0**	**51.6**	**53.2**	**54.6**
Consumption expenditure	12.5	12.9	13.5	13.7	13.9	14.0
Subsidies and current transfers, total	34.7	36.1	37.5	37.7	37.5	38.1
to general government	23.3	24.5	25.4	25.7	25.4	25.9
Interest expenses	2.6	2.7	2.4	2.5	2.5	2.6
Capital expenditure [4)]	4.4	4.6	4.5	4.6	4.7	4.9
Total expenditure	**54.2**	**56.3**	**57.9**	**58.5**	**58.6**	**59.6**
Net lending (+) / net net borrowing (-)	**-6.4**	**-7.3**	**-7.0**	**-6.9**	**-5.4**	**-5.0**
Primary balance[5)]	-4.3	-5.1	-5.0	-4.8	-3.3	-2.9

[1)] As calculated in the national accounts.
[2)] Incl. capital taxes.
[3)] Incl. capital transfers (excl. capital taxes) and consumption of fixed capital.
[4)] Gross fixed capital formation and capital transfers.
[5)] Net lending before net interest expenses.

2.2.1 Central government expenditure

Central government's national accounts expenditure increased by 2.9% last year, slightly less than the average for the past 10 years. In real terms expenditure increased by just over one per cent. Over the next few years expenditure growth will be slightly slower.

Over half of central government expenditure, some EUR 30 billion consists of current transfers. Transfers to local governments and social security funds account for EUR 25 billion of this, the remainder are transfers to other domestic sectors and to the EU. Close to one-quarter of central government expenditure consists of consumption expenditure, mainly of wages and salaries to employees and acquisitions of goods and services. Other major central government expenditure items include pensions, investment expenditure and interest expenditure. By function, central government's biggest expenses are in the areas of social security, public administration and education.

It is predicted that central government expenditure will rise quite slowly over the medium term among other reasons because of the need for continued adjustment measures. The ratio of central government expenditure to GDP will be at its highest in 2014 and 2015, after which it will slowly begin to fall, although still remaining higher than before the 2008–2009 recession. Expenditure growth will be slowest in transfer expenditure and consumption expenditure. It is expected that investment will show slightly faster growth than these expenditures.

Interest expenses have remained quite moderate because of low interest rates and the country's strong credit rating, even though central government debt has risen appreciably since 2008. In 2013 national accounts interest expenses amounted to just over 4% of total expenditure, compared to the peak figure of almost 16% in 1997. Despite the increasing level of central government debt, interest expenditure will remain low both this year and the next couple of years. However interest expenses will then begin to accelerate with the growing amount of debt and rising interest rates.

2015 State Budget and Central Government Spending Limits

Committed to a responsible and long-term spending policy that is designed to ensure economic stability throughout the electoral term, the new Government has decided to persist with the expenditure rules and expenditure ceiling adopted by the Government of Prime Minister Jyrki Katainen. The spending limits system covers some 80% of total on-budget expenditure.

The 2015 budget proposal is based on the April 2014 general government fiscal plan for 2015–2018 and on the June 2014 programme of Prime Minister Stubb's Government. The central government expenditure ceiling takes account of the expenditure savings adopted in the spending limits decisions taken during the electoral term.

The 2015 expenditure ceiling level is set at EUR 42,142 million, of which some EUR 80 million is set aside as an unallocated reserve after the 2015 budget proposal. A further EUR 200 million is reserved for supplementary budget needs. Items excluded from the spending limits rule 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. However expenditure effects resulting from changes to the criteria for these items are included in the spending limits. 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. In addition the Government has decided to budget the transfer to resolution fund as expenditure excluded from the spending limits, which is an exception to the spending limits system. Total expenditure outside the spending limits in 2015 comes to around EUR 11.8 billion.

The 2015 budget proposal puts central government expenditure at around EUR 53.7 billion, down by approx. EUR 0.4 billion from the 2014 ordinary budget. Government-agreed savings will increase by a net total of some EUR 2 billion compared to savings in 2014. On the other hand, central government expenditure will be increased by additional investment in the capitalisation of industrial growth-stage companies and bioeconomy businesses, Tekes loans, subsidies for renewable energy production, the reform of the housing allowance system and the development of services for the elderly. Furthermore expenditure will be increased by certain automatic factors, such as statutory and contractual revisions of price and cost levels and the growth of central government pension expenditure. Interest outlays on central government debt come to almost EUR 1.8 billion, slightly less than in the current year.

In 2015 it is estimated that on-budget revenue (excluding borrowing) will reach around EUR 49.2 billion and tax revenue around EUR 40.0 billion. On-budget revenue will be over 4% higher than budgeted for 2014 (including supplementary budget proposals). The growth of tax bases will be constrained by zero economic growth in 2014 and modest economic growth in 2015. Proposals are in place to increase several excise duties with a view to improving balance in central government finances.

The budget proposal for 2015 shows a deficit of EUR 4.5 billion, which will be covered by increased government debt. At year-end 2015 it is estimated that central government debt will be around EUR 102 billion.

The on-budget deficit will increase by some EUR 0.6 billion compared to the spring 2014 general government fiscal plan. The single biggest factors in this change are the deteriorating economic outlook compared to the forecast in spring 2014 as well as the tax base changes adopted in the Government Programme, which are above all reflected in lowered estimates for central government tax revenue.

Factors impacting change in central government budget balance compared to the General Government Fiscal Plan of 3 April 2014, EUR billion

	2015
Balance, general government fiscal plan, 3.4.2014	**-3,9**
UPDATED EXPENDITURE ESTIMATE	**-0,3**
Deterioration of cyclical forecast	-0,2
Updated projected interest payments on central government debt	0,1
Discretionary and other change	-0,2
UPDATED REVENUE ESTIMATE	**-0,3**
Deterioration of cyclical forecast and tax accruals	-0,5
Updated estimate of changes to tax criteria	-0,4
Discretionary and other change	0,6
Change, total	**-0,6**
Balance, budget proposal 2015	**-4,5**

2.2.2 Central government revenues

Taxes account for the largest source of central government revenue. The major tax revenue items are corporate income tax, taxes on earned and capital income and value added tax, which together account for around 70% of central government tax revenue. Tax revenue growth is dependent on the broader performance of the economy and the structure of economic growth. Overall tax accrual is also affected by Government decision-making. Furthermore changes to the apportionment of tax receipts between central government, local government and parishes influence the amount of tax revenue raised by central government.

The economy has shown no growth for the past two years, but even so several tax revenue items have increased moderately. This is explained in part by numerous tax base changes as part of central government's adjustment programmes, most significantly the increase of all VAT rates by one percentage point and several excise duty hikes.

In 2014 the major tax bases will show only very moderate growth, and therefore tax revenue growth will be slow. Revenue from earned income taxes will be adversely affected by the poor employment situation, and VAT revenue will be depressed by slow private consumption growth. It is estimated that national accounts tax revenue will increase by 1.5% The most significant tax base change in the current year is the reduction of the corporate income tax rate.

In 2015 the most important tax bases will continue to show historically weak development, even though it will accelerate from the year before. The most significant tax base changes in 2015 are the increases in excise duties (electricity tax, excise duties on tobacco,

Table 19. Forecasts for certain revenue and demand items impacting taxable income and the tax base in 2012-2018, annual change

	2012	2013	2014	2015	2018/2015**
	change. % per year				
Taxable earned income and capital income	3.2	3.0	2.4	2.0	2 1/2
Wage and salary earnings and other income	3.7	0.9	0.9	1.7	2
Pensions and other social security benefits	5.9	6.4	5.0	2.4	3 1/2
Capital income	-14.7	9.7	2.5	3.1	3 1/2
Index of wage and salary earnings	3.2	2.2	1.4	1.2	1 1/2
Operating surplus	-9.8	-0.1	-0.3	4.0	4 1/2
Value of household consumption expenditure	3.3	1.9	1.3	1.7	2 1/2
VAT base	3.0	0.9	1.1	1.8	3
Petrol consumption	-3.6	-2	-2½	-2.0	-2
Diesel consumption	-0.4	-0.8	-½	1	1
Electricity consumption	- 3/4	-5.1	1	3½	1.3
Duty-paid alcohol consumption	-1.8	-4.3	0	-2	-2
New passenger cars	-11.5	-7.2	1.7	3.9	4
Consumer price index	2.8	1.5	1.1	1.5	1 1/2

sweets and transport fuel) and other increases in indirect taxation¬. Tax base changes will also be made to earnings and capital income taxes. It is estimated that tax revenue in 2015 will increase by around 2.2% from the previous year.

In 2016–2018 it is estimated that tax revenue will increase on average by close to 4% a year. During this period some tax base changes will be introduced, and at the same time some of the temporary measures adopted by the Government will expire.

As for other sources of central government revenue, the single biggest items are property income and transfers from the State Pension Fund. Transfers from the State Pension Fund cover 40% of central government's annual pension expenditure. In its spring 2014 spending limits discussions the Government of Jyrki Katainen decided to draft a legislative amendment that would allow for increased transfers from the State Pension Fund next year. Under this amendment an additional EUR 0.5 billion will be transferred from the fund. As part of the spring 2014 spending limits discussions the Government additionally decided on additional revenue recognitions from public enterprises. It is expected that other central government property income will also increase more than usual in 2014 and 2015.

Taxes on earned and capital income

Revenue from earned and capital income taxes consists of receipts from progressive income tax, slightly progressive capital income tax and withholding tax paid by people with limited tax liability. The most significant source of revenue is earned income tax. Almost 70% of the earned income tax base consists of wage and salary earnings, over 25% of taxable social benefits and less than 5% of other revenue, such as earnings from shared business income. Central government is the only beneficiary of capital income tax revenue, whereas revenue from earned income taxes is divided between central government and local governments.

Table 20. Impact of change in selected tax base items on tax revenue

Tax category	Tax base / Demand item	Change	Change in tax revenue, EUR million
Taxes on earned income	Wage and salary earnings	1-pp	379 of which central govt. 127 and local govt. 170
	Pension incomes	1-pp	116, of which central govt. 29 and local govt. 75
Capital income tax	Investment income	1-pp	29
Corporate tax	Operating surplus	1-pp	40, of which central govt. 25 and local govt. 14
VAT	Value of private consumption	1-pp	121
Car tax	Sales of new cars	thousands	7
Energy tax	Electricity consumption	1%	10
	Petrol consumption	1%	13
	Diesel consumption	1%	14
Duty on alcoholic beverages	Alcohol consumption	1%	14
Duty on cigarettes	Cigarette consumption	1%	7

In 2014 earned income growth will be very slow. However central government earned income and capital income tax revenue will increase considerably as the apportionment of tax receipts will be revised to the benefit of central government. As part of the Pact for Employment and Growth signed by the labour market confederations in autumn 2013, central government took the step to raise income thresholds in the earned income tax scales by 1.5%, with the exception of the highest income bracket. In addition changes were made to the taxation of dividend incomes which will increase revenues from earned income and capital income taxes.

In 2015 wage and salary earnings will rise more sharply, which will bring increased revenue from earned income and capital income taxes. Prime Minister's Stubb's Government Programme includes a commitment to make full adjustments for inflation in earned income taxation in the three lowest income brackets in 2015. Other tax base changes include increases to the earned income deduction and pension income deduction and the child deduction. The progressiveness of capital income taxes will be increased and inheritance and gift tax scales increased by one percentage point.

In the medium term revenue from earned income and capital income tax will increase on average by 5% a year. The forecast assumes that in 2016, no changes will be made to the earned income tax scale to reflect rising earnings levels or inflation. For 2017 and 2018, by contrast, the tax scale will be revised for higher earnings or inflation.

Corporate income tax

Revenue from corporate income tax paid by businesses on their profits is shared between central government, local government and parishes. Corporate income tax is one of the most cyclically sensitive forms of tax. The forecast for corporate income tax revenue assumes that the tax base loosely follows the development of the national accounts operating surplus, and the forecast for the current year also takes account of tax revenue data for the early part of the year.

In the past three years the corporate income tax rate has been lowered in total by 6.5 percentage points. The thinking is that a lowered tax rate will have positive long-term effects. For instance, it is expected that it will influence choices of business form, company financing structure, the transfer of profits, and the amount and direction of investments made.

The operating surplus will not increase in 2014, and the introduction of a lowered tax rate from the beginning of the year will significantly reduce overall revenue from corporate income tax. This will be reflected most notably in central government corporate income tax revenue as the tax revenue losses resulting from the lowered tax rate will be compensated to local governments.

The increase in operating surplus in 2015 will also bring increased revenue from corporate income tax. The tax base decision made earlier to remove the right of businesses to deduct entertainment expenses was reversed in Prime Minister's Stubb's Government Programme. This will slightly reduce the amount of revenue from corporate income tax.

In the medium term it is estimated that corporate tax revenue will increase in line with the operating surplus, i.e. on average by around 4.5% a year. The temporary increase in the apportionment of corporate income tax revenue paid to local governments will expire in 2016, which in turn will considerably increase central government revenue from corporate income tax.

Actual central government revenue from corporate income tax may differ from the overall development of corporate income tax revenue, for several reasons. Corporate income tax revenue for the calendar year may increase more slowly or more rapidly than the corporate income tax for the tax year. Taxes for a given tax year accumulate over a period of many years, and the level of supplementary prepayments made in the year following the tax year, for instance, varies widely.

Furthermore the net effect of the corporate income tax base changes made will be compensated to local governments and parishes by increasing their share of corporate income tax revenue accordingly.

Indirect taxes

The most significant sources of indirect tax revenue are energy taxes, value added tax and the motor car tax. In recent years the focus of tax policy has shifted increasingly to indirect taxes.

Several tax base changes have been introduced to energy taxes in recent years, and further changes will be introduced in the next few years. The electricity tax will be increased from the beginning of next year, and the CO2 tax on fossil heating, power plant and machinery fuels will be raised. Transport fuel taxes will also be raised. By contrast the planned tax on power plants has been scrapped. Furthermore the waste tax will be increased and the scheduled tax hike on peat in 2015 has been cancelled.

Revenue from other excise duties will grow more steadily than energy taxes. Tax hikes were put in place from the beginning of the year for tobacco, alcoholic beverages, sweets, ice cream and soft drinks. These changes will increase tax revenue from excise duties during the current year. The tobacco tax will be further increased from the beginning of 2015, and the sweet tax will also be increased.

Revenue from the motor car tax fluctuates sharply. Passenger cars account for around 90% of total revenue from the motor car tax. It is estimated that in the coming years demand for cars will remain lower than over the past few years. Revenue from the motor car tax will increase with the reduction of tax subsidies in 2015 because the reduced car tax rate will no longer be applied to taxis (excluding specially equipped taxis) or motor vehicles imported into Finland as removal goods. The forecast is that the motor car tax will rise on average by 5% a year over the outlook period. The vehicle tax is a time-based tax that is levied in 12-month periods on passenger cars, vans and heavy goods vehicles. The annual vehicle tax was increased at the beginning of 2013, and a further increase will be introduced from the beginning of 2016.

The accuracy of the VAT revenue forecast depends crucially on the accuracy of forecasts of the development of private consumption, both in terms of value and contents. It is projected that private consumption will show historically very moderate growth over the outlook period, effectively ruling out the prospects of a sharp rise in VAT revenue. The forecast for national accounts VAT revenue growth this year is less than one per cent. As the growth of tax bases gathers momentum, VAT revenue growth will also accelerate in 2015–2018, averaging around 3%.

Table 21. Central government on-budget revenue: estimates for 2012-2018, EUR billion

	2013 provisional financial accounts	2014 budget incl. supplementary budget proposal	2015	2016	2017	2018	2018/2015 annual change. %
Total tax revenue estimates	38.7	39.2	40.0	41.7	43.1	44.6	3
Income and wealth taxes[1]	12.1	12.1	12.1	13.0	13.8	14.6	4
Taxes based on turnover	17.3	17.5	17.8	18.4	19.0	19.6	2 1/2
Excise duties	6.6	6.7	7.2	7.2	7.1	7.1	1 1/2
Other taxes	2.8	2.9	3.0	3.1	3.2	3.3	3 1/2
Miscellaneous revenue	5.1	4.9	6.0	5.2	5.3	5.2	1
Interest income and profit entered as income	2.0	2.6	2.8	2.0	2.0	2.0	1
Total revenue estimates	**46,2**	**47,2**	**49,2**	**49,3**	**50,8**	**52,1**	**2**

[1] Incl. YLEtax from 2013 onwards (on average 500 EUR million per year).

Table 22. Impact of discretionary tax measures on general government tax revenue

	2013	2014	2015	2016	2017	2018
	EUR million					
Earned income taxes	90	-33	-144	56	-76	-94
Average increase in municipal tax rate	135	360	0	0	0	0
Investment income tax	108	74	88	45	0	0
Corporate tax	-50	-921	106	-27	0	0
YLEtax	440	77	-6	7	5	0
Other direct taxes	166	112	58	20	0	0
Value-added tax	742	151	2	0	0	0
Energy taxes	76	169	311	37	1	0
Other indirect taxes	177	167	210	108	0	0
Social security contributions	11	580	306	279	205	155

2.2.3 On-budget accounts and national accounts

The on-budget balance differs in many respects from the financial position described on a national accounts basis, i.e. in net borrowing terms. For the past five years the financial position described in national accounts terms has been slightly better than the on-budget balance, even though both figures have been firmly in deficit. The differences between on-budget and national accounts deficits are described in the Table below.

The concepts and classifications applied in on-budget accounts and in the national accounts differ in many respects. For instance, the content of consumption expenditure items in on-budget accounts differs considerably from national accounts consumption expenditure, and on-budget investment expenditure covers only a small part of expenditure classified as investment in the national accounts. In the new national accounting system R&D expenditure is treated as investment, whereas in the State Budget it is divided between several items, primarily in the administrative branches under the Ministry of Education and Culture and the Ministry of Employment and the Economy.

In the national accounts, central government finances are defined as comprising all on-budget entities as well as 10 extra-budgetary funds, but not the State Pension Fund, which comes under the earnings-related pension institutions sector. Universities are not included in the State Budget, although they do still come under the national accounts central government concept. The state-owned investment company Solidium is also included in central government in the national accounts, as is the public service broadcaster YLE.

The reform of the national accounting system broadened the central government sector even further, which now additionally includes Senate Properties and universities' property companies.

Financial investments such as central government loans, capitalisations and share purchases are entered in the State Budget as expenditures. Loan repayments, revenue from sales of shares, etc., are accordingly entered on the revenue side. In the national accounts, these items are entered as financial transactions, which do not affect central government's fiscal balance as measured by net borrowing. For 2014 and 2015, for instance, revenues of around one billion euros have been budgeted for revenue from sales of shares, which will reduce the net borrowing requirement in the Budget but have no effect on budgetary position in the national accounts.

One significant difference comes from the use of deferrable appropriations. These are two or three-year grants that are entered in the Budget for one year only. In the national accounts, deferrable appropriations are entered on the basis of their use. The net effect of deferrable appropriations can vary widely from year to year.

All EU countries are required to report twice a year to Eurostat on the differences between their on-budget and national accounts figures in connection with their deficit and debt reporting. Published on the Eurostat website, these reports describe the differences between on-budget accounting and national accounts not only for central government, but also for other general government subsectors. The significance of these reports has been further highlighted by increased EU economic policy coordination.

Table 23. On-budget balance and central government net lending[1)]

	2012	2013*	2014**	2015**	2016**
	EUR billion				
On-budget surplus (+)/deficitT (-) [2)]	**-7.8**	**-8.4**	**-7.4**	**-4.5**	**-4.1**
Privatization proceeds (net proceeds from equity sales)	-0.1	-0.1	-1.0	-1.2	-0.5
Financial investment, net	0.7	0.9	0.2	0.5	-0.2
Rvenue surplus in off-budget units	-0.5	-0.6	0.0	0.0	0.0
Cash/accrual basis adjustment	0.0	0.3	0.3	0.3	0.3
Other adjustment items [3)]	-0.4	0.2	0.4	-1.2	-1.2
Central government net lending (+) /-borrowing (-)	**-7.3**	**-7.0**	**-6.9**	**-5.4**	**-5.0**

[1)] In national accounts terms.

[2)] Incl. government debt servicing.

[3)] Incl. debt cancellations, profit on reinvested foreign direct investments, super dividends

2.3 Local government

In 2013 the local government deficit stood at 0.8% of GDP. The local government financial position improved by EUR 0.5 billion from the previous year, partly on account of one-off items. The growth of local government consumption expenditure slowed and staff numbers decreased. Tax revenue, on the other hand, increased quite strongly given the sluggish economy. The growth of local government tax revenue was primarily due to one-off factors, such as the ad-justment of earned income and capital income tax apportionments between local and central government in favour of local governments. The average municipal tax rate rose by 0.1 percentage point to 19.38%.

In 2014 the local government deficit-to-GDP ratio will remain at 0.8%. Despite sluggish tax base growth, tax revenue is predicted to increase by 2.3%. This growth is driven by increases to municipal tax rates. The average municipal tax rate increased to 19.74% at the beginning of the year, and some municipalities put up their real estate tax rates. Local government tax revenue will also be increased by changes made to the criteria for real estate evaluations. Central government transfers to local governments, by contrast, will fall as a result of central government adjustment measures.

Economic stringency will force local governments to curb the growth of their expenditure in 2014. Each year some 16,000 local government employees retire, and it is expected that some of these positions will be left unfilled. Moderate wage development and cost levels and municipal employers' lowered social security contributions will also help to curb the growth of local government expenditure.

The reform of the national accounting system in July 2014 brought some changes in the local government sector and its financial transactions. Under the new system some 150 municipally owned companies (such as universities of applied sciences) have been transferred from the private and non-profit sector to the local government sector. These changes increased both the overall revenues and expenditure of the local government sector. The impacts on net borrowing were minor.

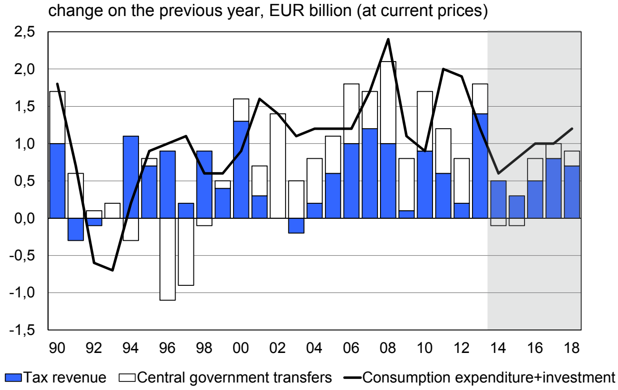
State of local government finances set to deteriorate in 2015

In 2015 it is projected that the local government deficit-to-GDP ratio will increase to 1.1%. This forecast is based on unchanged policies, i.e. on already agreed-upon economic and fiscal policy measures for which adequate information is available. Increases to municipal tax rates or other adjustment measures taken by local governments were not assumed. Economic growth will rebound in 2015, but tax base growth will continue to remain subdued. It is projected that local government tax revenue growth in 2015 will be just over 2%. The Governments of Jyrki Katainen and Alexander Stubb have adopted tax base changes that will both increase and decrease local government tax revenue: overall these measures will have the effect of reducing tax revenue by close to EUR 130 million. This will be compensated through increased central government transfers to local government, and therefore the tax base changes will have no effect on the local governments' financial position. Central government transfers to local government will be reduced by 0,7 % in 2015. Central government adjustment measures will include cuts of almost EUR 190 million in transfers to the local government sector. Overall it is estimated that local government tax revenue and central governments transfers will increase by just 1% in 2015.

It is predicted that local government expenditure levels will continue to rise moderately in 2015. Earnings in the local government sector will increase by just over 1%. The net effect of changes in employer contributions will also act to curb expenditure. On the other hand population ageing and the associated growth in the demand for services will drive expenditure growth in local governments to over 2%.

Local government taxes, central government transfers, consumption expenditure and investment

change on the previous year, EUR billion (at current prices)



Sources: Statistics Finland, MoF

Continued growth in local government indebtedness in 2016–2018

In an unchanged policy scenario, the outlook for the local government sector in 2016–2018 is bleak. In the absence of new measures to strengthen local government finances, expenditure growth will continue to outpace revenue growth. By 2018 the local government deficit will grow to EUR 2.6 billion or 1.1% of GDP. Local government debt will increase to over EUR 26 billion, or more than 11% of GDP.

Under its Structural Policy Programme the Government is committed to reduce the duties and obligations of local governments by a total of EUR 1 billion by 2017. Furthermore the aim of the policy programme is to strengthen local government finances by EUR 1 billion through local government's own actions. The targeted savings effects can be incorporated in the local government projection as measures are agreed upon and their impacts can be reliably assessed. According to preliminary estimates the measures included in the General Government Fiscal Plan for 2015–2018 covered over one-third of the targeted savings of one billion euros. Among the measures intended to reduce the duties and obligations of local governments, this calculation takes account of the measures insofar as they are expected to bring savings by 2018. Measures taken by local governments themselves are not taken into account in line with the unchanged policy principle.

In order to secure the sustainability of local government finances it is necessary that the Structural Policy Programme is implemented in full. The stabilisation of local government finances will also require that municipalities are committed to continue their economic adjustment efforts and to take steps to increase productivity. Population ageing and the associated increase in the demand for services is severely hampering the efforts of local governments to curb expenditure growth. Unless the duties and obligations of local governments are significantly reduced, therefore, the only way to halt the growth of local government indebtedness would be through sharp increases to municipal tax rates. If this were the only avenue chosen to regain balance in local government finances, the average municipal tax rate would increase by some 2½ percentage points in 2015–2018.

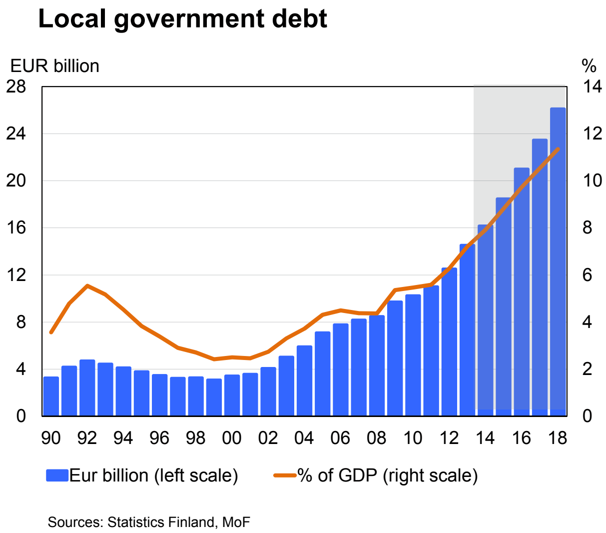


Table 24. Local government [1)]

	2011	2012*	2013*	2014**	2015**	2016**
	EUR billion					
Taxes and social security contributions	19.2	19.4	20.7	21.2	21.6	22.1
of which municipal tax	16.3	16.9	17.9	18.3	18.6	19.1
corporate tax	1.6	1.2	1.5	1.4	1.5	1.3
real estate tax	1.2	1.3	1.4	1.5	1.6	1.6
Other revenue [2)]	17.1	17.9	18.4	18.4	18.4	18.8
of which interest receipts	0.3	0.3	0.2	0.3	0.3	0.3
of which transfers from central government	12.9	13.5	13.9	13.8	13.7	14.0
Total revenue	**36.2**	**37.2**	**39.1**	**39.6**	**40.0**	**40.9**
Consumption expenditure	30.6	32.2	33.2	33.7	34.4	35.4
of which compensation of employees	20.5	21.4	21.6	21.6	21.8	22.1
Income transfers	2.8	3.0	3.0	3.1	3.3	3.4
of which social security benefits and allowances	1.1	1.2	1.3	1.3	1.3	1.4
subsidies and oher transfers	1.4	1.5	1.6	1.6	1.8	1.8
interest expenses	0.2	0.2	0.2	0.2	0.2	0.2
Capital expenditure [3)]	3.9	4.1	4.5	4.4	4.5	4.5
Total expenditure	**37.3**	**39.3**	**40.7**	**41.2**	**42.3**	**43.3**
Net lending (+) / net borrowing (-)	**-1.1**	**-2.1**	**-1.6**	**-1.7**	**-2.2**	**-2.5**
Primary balance [4)]	-1.1	-2.2	-1.7	-1.7	-2.3	-2.5

[1)] As calculated in the national accounts.

[2)] Incl. capital transfers and consumption of fixed capital.

[3)] Gross capital formation and capital transfers.

[4)] Net lending before net interest expenses.

2.4 Social security funds

2.4.1 Earnings-related pension funds

In 2013 the surplus of earnings-related pension funds fell to 1.9% of GDP, down from 2.4% in 2012. In the past five years the surplus of earnings-related pension funds has decreased by more than 2 percentage points. Earnings-related pension expenditure has risen sharply in recent years with the growing number of pensioners and with the higher average level of pensions, as new pensions are higher than the old ones in payment. The weaker employment situation and slower rise in earnings have in turn dampened the growth of incomes from contributions, even though pension contribution rates have increased sharply in recent years. Low interest rates have in turn reduced interest revenue on pension assets. However the total value of pension assets had climbed to EUR 162 billion by year-end 2013.

The growing number of pensioners and the rise in the average pension will continue to drive earnings-related pension expenditure growth throughout the outlook period in 2014–2018. Pension expenditure growth will be slowed by the spring 2014 decision to freeze the earnings-related pension index increment to 0.4% in 2015. Slower inflation and rises in earnings mean that annual indexations of pensions will remain at less than 2% in 2016–2018. Earnings-related pension expenditure will increase at an annual average rate of 5% throughout the forecast period. Pension expenditure to GDP will climb to almost 14% in 2018, compared to the figure of 10% in 2008.

The earnings-related pension contribution increased by 0.8% from the beginning of 2014, returning to the previously agreed track after the decision last year to suspend the increase. Pension contributions as a proportion of the wage bill will exceed 25% this year. It has been agreed that earnings-related pension contributions will increase by 0.4 percentage points in 2015 and 2016, with the burden shared equally by employees and employers. Wage bill growth will remain sluggish both this year and next as a result of weak employment growth and moderate pay rises, which will act to slow the growth of revenue from pension contributions. It is expected that proceeds from pension assets will increase moderately from 2016 as interest rates begin to rise.

In 2014 the pension funds surplus will fall to 1.7 % of GDP. In 2015 the financial position of earnings-related pension funds will continue to weaken due to an additional one-off transfer of EUR 500 million from the State Pension Fund to central government. In 2016–2018 earnings-related pension funds will show a surplus of 1.8% to GDP[1]. Increased revenue from higher pension contributions and higher interest revenues under rebound conditions will not, however, push the surplus of earnings-related pension funds to growth as pension expenditure is projected to continue to grow sharply over the medium term.

1 The medium-term forecast assumes that earnings-related pension contributions will increase by 0.3 percentage points relative to the total wage bill in 2017 and by 0.2 percentage points in 2018.

Table 25. Finances of social security funds[1)]

	2011	2012*	2013*	2014**	2015**	2016**
	EUR billion					
Investment income	4.0	3.8	3.7	3.7	4.1	4.7
Social security contributions	24.0	25.5	25.9	26.7	27.4	28.4
of which contibutions paid by employers	17.0	17.7	17.9	18.3	18.7	19.2
contributions paid by insured	7.1	7.8	8.0	8.4	8.8	9.2
Transfer from general government	11.6	12.3	12.9	13.2	13.2	13.5
Other revenue	0.5	0.5	0.5	0.5	0.5	0.6
Revenue	**40.2**	**42.0**	**43.0**	**44.2**	**45.3**	**47.1**
Consumption expenditure	3.4	3.6	3.5	3.7	3.7	3.8
Social security benefits and allowances	28.7	30.6	32.7	34.5	35.4	36.5
Other outlays	2.7	2.7	2.9	3.0	3.6	3.1
Expenditure	**34.8**	**36.9**	**39.1**	**41.1**	**42.7**	**43.4**
Net lending (+) / net borrowing (-)	**5.4**	**5.2**	**3.8**	**3.1**	**2.6**	**3.8**
Earnings-related pension schemes	5.4	4.8	3.8	3.5	3.1	3.9
Other social security funds	0.0	0.4	0.0	-0.4	-0.5	-0.1
Primary balance[2)]	3.4	3.5	2.1	1.6	1.0	2.0

[1)] As calculated in the National Accounts.

[2)] Net lending before net interest expenses.

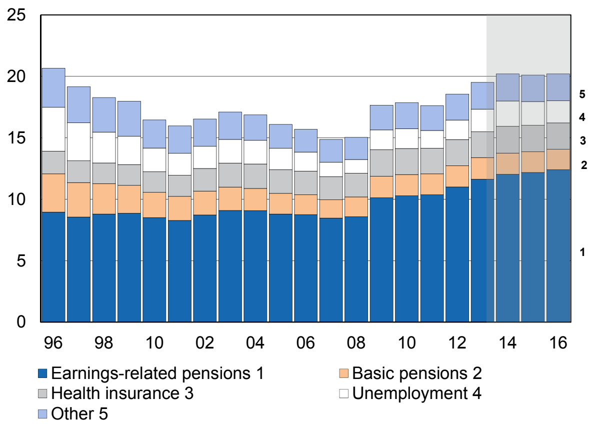
2.4.2 Other social security funds

Other social security funds include the Social Insurance Institution (Kela) and the Unemployment Insurance Fund, which are responsible for the provision of basic security and for earnings-related unemployment security, respectively. The expenditure of other social security funds increased by 5.5% in 2013. This sharp growth was attributable to rising earnings-related unemployment security expenses, which were up by 16%, and the growth of basic unemployment security, up 18%. Sickness insurance expenditure fell marginally last year as a result of reduced reimbursements of medicines and travel expenses as set out in the Government Programme. Transfers from central and local government to other social security funds increased by EUR 470 million from the previous year, allowing these funds to maintain financial balance in 2013.

It is forecast that unemployment-related expenditure will still rise in 2014, climbing to over EUR 4 billion, but then begin to fall with lowered unemployment towards the end of the outlook period. Unemployment expenditure will be reduced by the decision to cut earnings-related unemployment expenditure by EUR 50 million from 2015. Furthermore sickness insurance expenditure will be reduced by EUR 51 million next year. Despite these savings sickness insurance expenditure is projected to increase on average by 3% a year over the outlook period. There will also be expenditure savings as a result of the 0.4% increase in the national pension index in 2015, which is 0.7 percentage points less than the normal index adjustment. As a result of these savings decisions expenditure by other social security funds will not increase next year. In 2016–2018 it is estimated that expenditure will increase on average by 1.5% a year.

Employees' sickness insurance contribution increased by 0.12 percentage points and employers' income security contribution by 0.1 percentage point from the beginning of this year. Employees' and employers' unemployment insurance contribution, on the other hand, fell by 0.1 percentage point. As a result of the lowered unemployment security contribution and the growth of unemployment expenditure, the financial position of the unemployment security fund, and by the same token that of other social security funds, will show a deficit of 0.2% of GDP this year. In the medium term other social security funds will be close to balance. The relative contributions of the local government sector and central government to Kela financing will be revised in 2015 as local governments assume responsibility for the financing of long-term unemployment. From the beginning of 2017 Kela will take over from local governments the task of calculating and making payments of basic income support.

Benefits, allowances and medical care reimbursements
% of GDP



Sources: Statistics Finland, MoF

Table 26. Social security contributions rates and pension indices

	2011	2012	2013	2014	2015*	2016**
SOCIAL INSURANCE CONTRIBUTIONS [1]						
Employers						
Sickness insurance	2.12	2.12	2.04	2.14	2.13	2.14
Unemployment insurance	2.32	2.32	2.32	2.20	2.20	2.20
Earnings-related pension insurance	17.1	17.35	17.35	17.75	17.95	18.15
Local government pension insurance	23.6	23.6	24.00	23.70	23.60	23.50
Employees						
Sickness insurance	2.01	2.04	2.04	2.16	2.17	2.22
Unemployment insurance	0.60	0.60	0.60	0.50	0.50	0.50
Earnings-related pension insurance	4.9	5.45	5.45	5.85	6.05	6.25
Pensioners						
Sickness insurance	1.36	1.39	1.47	1.49	1.51	1.55
Pension indices						
Earnings-related index (over 65)	2323	2407	2475	2509	2519	2556
National pension index	1508	1565	1609	1630	1637	1663

[1] Annual averages. The contributions of employers and the unemployment and employment pension contributions of beneficiaries as percentages of wages and salaries. The figures are weighted averages.

2.5 Long-term sustainability of public finances

It seems that despite the best adjustment efforts, balance will not be restored in public finances over the medium term, and that the public debt-to-GDP ratio will continue to rise. The challenge of balancing public finances is further compounded by population ageing, which is driving up pension expenditure and the costs from health care and long-term care. The slowdown of productivity growth and stalling labour input growth are in turn curbing economic growth and therefore slowing the growth of tax revenue.

The deterioration of the dependency ratio is putting general government finances under considerable pressure. Based on Statistics Finland's 2012 population projection, it is forecast that by 2030, the population aged 15–64 will drop by 84,000, at the same time as the number of people aged 65 or over will increase by 440,000. The long-term budgetary position of general government is measured by the sustainability gap, which is the current value of future public finance deficits. The sustainability gap indicates the extent of medium-term adjustment necessary in public finances in order to prevent public debt from spiralling out of control, in the long term, as a result of escalating age-related expenditure.

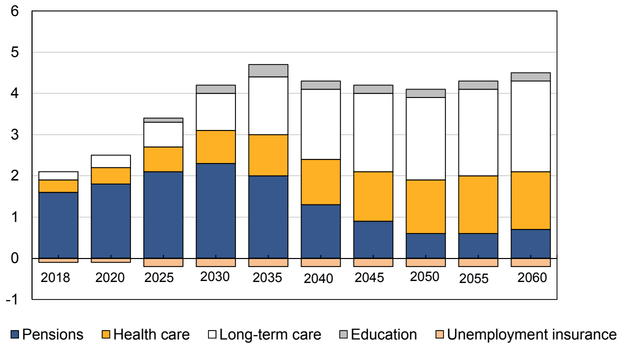
The projected sustainability gap has widened since the Ministry of Finance's spring estimate, as the structural budgetary position in general government has weakened in the medium term. There have been no changes in long-term expenditure pressures relative to the spring sustainability estimate. The sustainability gap is estimated at around 4% of GDP at an annual level in 2018.

The sustainability gap must be bridged, sooner or later. If the debt burden threatens to escalate out of control, market pressures will before long push up interest rates payable on the debt and necessitate adjustments in public finances. The sooner the decisions to balance public finances are made, the lower the costs involved.

The sustainability problem can be addressed through immediate budgetary adjustments, which will help to strengthen the structural financial position of general government, but also through reforms designed to curb future expenditure pressures and to strengthen the foundations for economic growth, and by the same token to increase public sector revenue growth in the long term.

The sustainability projection is in essence a pressure projection that reflects future trends under the existing set of rules based on long-term population projections, the weight of spending in different age groups, and economic development. The further one reaches ahead of time with the projection, the greater the uncertainty, which is why the projection is highly sensitive to the assumptions on which it is based.

Change in age-related expenditure
from year 2012, % of GDP



The figure is compiled using the model developed by the Ministry of Social Affairs and Health for social expenditure analysis.

Recent policy measures

24–25 March 2014

The Government agreed on the 2015–2018 central government spending limits and general government fiscal plan. These included new measures that will reduce central government expenditure and increase revenue by EUR 2.3 billion at an annual level in 2018. The net effect of all the savings and revenue enhancement measures introduced by the Government during its term in office comes to around EUR 6.6 billion at an annual level in 2017, or to 3% of GDP when compared to the last spending limits decision of the previous electoral term.

On the taxation side, the adjustment measures consist mainly of increases to excise duties and changes designed to increase the fairness of earned income and capital income tax. In 2015 earned income taxes will be raised by refraining from tax scale adjustments for real earnings growth and inflation. This will increase tax revenue by some EUR 155 million. However, taxes on low income earners will be eased by EUR 100 million by raising the basic and earned income deductions. The lower limit of the highest income bracket in the progressive income tax scale will be lowered to EUR 90,000, and the validity of the income category will be extended to 2018. These measures will have the effect of reducing income differentials.

Changes to capital income taxation will increase tax revenue by EUR 28 million and at the same time narrow income differentials. Taxes on capital income will be increased so that the income limit of the higher tax rate will be lowered to EUR 30,000 and the higher rate increased to 33%. Inheritance and gift taxes will be increased by raising all marginal rates in the tax scales by one percentage point. In addition, the tax class of gifts and inheritances of over EUR 1,000,000, which was previously prescribed as temporary, will be made permanent from 2016.

The Government has committed itself to launch by 2015 a package of measures designed to close the sustainability gap. On 29 August 2013 the Government announced a new structural policy programme aimed at improving the conditions for economic growth and at bridging the sustainability gap. On 29 November 2013 the Government further elaborated the programme and announced its decision on implementation. The central government spending limits include those structural policy programme measures that have cost effects and that are at an advanced enough stage of preparation.

Central government on-budget expenditure in 2015 will be around EUR 53.5 billion. It is estimated that over the spending limits period, expenditure will rise nominally by an average annual rate of just under one per cent. In real terms, expenditure will fall by an estimated 0.5% a year. It is estimated that on-budget ordinary revenue will show an annual average increase of 3.3% over the planning period. Tax revenue is forecast to increase by 3.6% a year. Tax revenue will account for an average 85% of on-budget ordinary revenue. In 2018 it is estimated that on-budget revenue (excluding borrowing) will reach EUR 53.4 billion. Based on the projected development of appropriations and revenue estimates, it is estimated that central government will show a budget deficit of around EUR 2.7 billion in 2018. It is thought that the adjustment package will be sufficient to reverse the central government debt to GDP ratio during the spending limits period. The Government will announce its fiscal plan for 2015–2018 at its meeting on 3 April 2014 and subsequently submit the plan to Parliament.

3 April 2014

The Government announced its fiscal plan for 2015–2018. This is the first plan of its kind, covering not only central government finances but also local government finances, statutory pension institutions and other social security funds. The Government's decision reflects the rules and regulations governing fiscal management, the overall targets set as well as the broader environment for the management of public finances overall and by sector. Furthermore the plan specifies the fiscal policy pursued by the Government in seeking to achieve its targets. The decision amends the overall spending limits issued for the electoral term in October 2011 to reflect the 2015 price and cost level and structural changes. Furthermore, the decision lays down the real spending limits for the electoral term 2015- 2018 and so sets the framework for the 2015 budget and supplementary budget proposals. The Government decided to submit its report to Parliament.

17 April 2014

The Government approved the Finnish Stability Programme, which outlines the country's economic policy premises and objectives, particularly in the fiscal policy area, and assesses the prospects of achieving those objectives through to 2018. The Stability Programme is based on the State Budget approved by Parliament on 20 December 2013 and on the 2015– 2018 fiscal plan approved by the Government on 3 April 2014 and the underlying forecasts. Despite the subdued growth outlook, Finnish public finances will improve over the stability programme period. In 2013 public finances showed a deficit of 2.1% of GDP. The Government adjustment package will strengthen above all the budgetary position of central government. According to the Stability Programme forecast, the general government budgetary position will move back to balance by 2017, and the general government debt to GDP ratio will begin to fall during the programme period. The medium target set for the structural budgetary position in the 2013 Stability Programme was −0.5% of GDP, and it was expected that this target would be achieved in 2014. In 2013 the structural budgetary position stood at −0.4% of GDP. According to the Stability Programme forecast the structural budgetary position in 2014 will be −0.7% of GDP. The Government's adjustment programme will contribute to strengthen the structural budgetary position during the planning period and turn it into a surplus in 2017.

The Government approved the spring 2014 National Programme for the Europe 2020 Strategy. The Programme includes an EU report describing how the Government proposes to achieve the national targets of the Europe 2020 Strategy endorsed in autumn 2011. The National Programme also considers the recommendations made by the Council of the European Union to Finland in 2013. The programme is structured in the same way as the spring 2013 programme. The main areas of focus this year are competitiveness, the diversification of the business structures and energy efficiency. The National Programme is based on the Europe 2020 Strategy adopted by the European Council in June 2010.

30 April 2014

The Government decided to submit to Parliament its 2013Annual Report.

22 May 2014

The Government submitted to Parliament its 2014 supplementary budget proposal. Net revenue is expected to increase by EUR 544 million, and net appropriations by EUR 520 million. The supplementary budget proposal for 2014 thus shows a surplus of EUR 24 million. Central government net borrowing in 2014 is estimated at EUR 7.1 billion. The remaining unallocated reserve for 2014 would be EUR 119 million. It is proposed that the net tax revenue estimate is revised downwards by EUR 190 million. Based on the weakening economic outlook and current tax accrual, estimated VAT revenue is down by EUR 165 million. The need for appropriations is up by a net total of EUR 520 million. It is proposed that in order to boost economic growth, appropriations be increased in line with the 2015–2018 fiscal plan by a total of some EUR 200 million.

5 June 2014

The ECB Governing Council decided to lower the interest rate for the Eurosystem's main refinancing operations to 0.15%, with effect from the operation to be settled on 11 June 2014.

12 June 2014

Parliament discussed and adopted the Government's report for the 2015–2018 fiscal plan.

18 June 2014

Parliament decided that the supplementary budget for 2014 will be put into effect as of 1 July 2014. The net revenue increase comes to EUR 544 million, and net appropriations are up by EUR 520 million. The supplementary budget proposal for 2014 thus shows a surplus of EUR 24 million.

18–19 June 2014

Alexander Stubb was tasked with conducting mini government programme talks. The programme of Prime Minister Stubb's new Government is based on the structural policy decisions taken by the former Prime Minister Katainen's Government and its policy of fiscal adjustment. The new Prime Minister and his Government are committed to follow earlier spending limits decisions, and public debt will stop growing in 2018.

The new growth measures are included in the Government Programme. In connection with the government talks decisions were also made on major new investments designed to boost growth and employment.

For example, the Government is committed to promote significant transport projects such as the City Rail Loop, the Western Metro Extension and the city tram line in Tampere. To bolster domestic demand, household purchasing power and employment, full adjustments for real earnings growth and inflation will be made in the three lowest income brackets in the taxation of pensions and earned income in 2015, and the adjustment freeze will be postponed until 2016. The position of families with children will be supported by developing the tax deduction system. Preparations for implementation will be completed before the Government budget discussions, taking account of the increases to basic and earned income deduction as agreed in the spending limits decisions.

Sources: Parliament documents search, Valtioneuvoston viikko publication, Ministry press releases, ECB bulletins

Appendix 2

Supplementary statistics

1. Evolution of forecasts over time
2. Outturn data and forecasts used in budget process for 2009-2013, average change, %
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6. Central government budgetary expenditure by financial accounts and the Budget
7. Government budgetary expenditure by administrative sectors in the financial accounts and the Budget
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9. Social Insurance Institution, national pension fund
10. Social Insurance Institution, national health insurance fund
11. Social Insurance Institution, Social Security General Fund
12. Contributions, pension expenditure and technical reserves of private employment pensions institutions

1. Evolution of forecasts over time[1]

	2013*				2014**				2015**				2016**			
	eb2	es1	eb1	es2	eb2	es1	eb1	es2	eb2	es1	eb1	es2	eb2	es1	eb1	es2
GDP at market prices, change in volume, %	-1.2	-1.4	-1.3	-1.2	0.8	0.5	0.2	0.0	1.8	1.4	1.4	1.2	-	1.8	1.6	1.4
Consumption, change in volume, %	-0.1	-0.3	-0.3	0.0	0.4	0.1	0.3	0.1	0.9	0.3	0.3	0.3	-	1.0	1.0	0.9
Exports, change in volume, %	-0.8	0.3	-1.3	-1.7	3.6	3.5	-0.5	0.4	4.1	4.1	4.6	4.0	-	4.8	4.8	4.6
Unemployment rate, %	8.2	8.2	8.2	8.2	8.4	8.4	8.5	8.6	8.2	8.3	8.4	8.5	-	8.1	8.1	8.2
Consumer price index, change, %	1.5	1.5	1.5	1.5	1.5	1.5	1.3	1.1	1.6	1.7	1.7	1.5	-	1.9	1.9	1.8
Central government net lending, % of GDP	-3.8	-3.7	-3.7	-3.5	-3.6	-3.5	-3.7	-3.4	-3.2	-2.4	-2.4	-2.6	-	-2.0	-2.2	-2.3
General government net lending, % of GDP	-2.6	-2.4	-2.5	-2.3	-2.5	-2.4	-2.6	-2.7	-2.0	-1.4	-1.7	-2.4	-	-0.9	-1.4	-1.7
Central government debt, % of GDP	46.6	46.4	46.3	44.6	49.3	48.7	49.3	47.6	50.7	49.3	49.8	48.5	-	49.2	50.0	49.0

[1] Release date: Economic Bulletin 19.12.2013 (eb2), Economic Survey 3.4.2014 (es1), Economic Bulletin 18.6.2014 (eb1) and Economic Survey 15.9.2014 (es2)

Sources: Statistics Finland, MoF

2. Outturn data and forecasts used in budget process for 2009-2013, average change, %

	Years 2009-2013		Average forecast errors	
	Forecast averages	Outcome averages	Forecast under-/over-estimation[1], pp.	Magnitude of forecast error[2], pp.
GDP (volume)	1.5	-0.7	2.2	4.0
GDP (value)	3.7	1.2	2.5	4.4
Private consumption (value)	3.7	2.8	0.9	3.1
Current account, % of GDP	1.3	-0.3	1.6	1.8
Inflaation	2.3	1.8	0.6	1.0
Wage bill	3.4	1.8	1.5	2.1
Unemployment rate	8.0	8.1	0.0	1.1
Central governmnet debt, % of GDP	41.4	41.9	-0.5	3.7
Central government net lending, % of GDP	-3.1	-4.2	1.1	1.7
General government net lending, % of GDP	-0.9	-2.2	1.3	2.2

Forecasts are compared with July preliminary national accounts data. Averages for the past five years are calculated on the basis of spring and autumn forecasts concerning the budget year.

[1] Over- or understimation is indicated by average forecast error.

[2] The average of absolute error values indicates the average magnitude of forecast errors. regardless of the direction of error.

3. National balance of supply and demand, EUR million

	Current prices					
	2011	2012*	2013*	2014**	2015**	2016**
GDP at market prices	196 869	199 069	201 341	204 056	209 397	215 677
Imports of goods and services	78 768	81 764	78 812	77 764	81 287	86 068
Total supply	**275 637**	**280 833**	**280 153**	**281 820**	**290 684**	**301 745**
Exports of goods and services	77 093	78 881	76 866	76 761	80 916	85 913
Consumption	152 262	157 709	161 263	163 590	166 466	170 547
private	105 771	109 026	111 046	112 542	114 431	117 304
public	46 491	48 683	50 217	51 048	52 035	53 243
Investment	43 779	44 305	42 596	41 480	43 090	45 124
private	36 301	36 409	34 290	33 099	34 577	36 400
public	7 478	7 896	8 306	8 381	8 513	8 724
Total demand	**273 134**	**280 895**	**280 725**	**281 831**	**290 472**	**301 584**
	At reference year 2010 prices; not additive					
	2011	2012*	2013*	2014**	2015**	2016**
GDP at market prices	191 910	189 111	186 831	186 893	189 079	191 734
Imports of goods and services	74 222	75 167	73 281	72 652	74 970	78 254
Total supply	**266 132**	**264 328**	**260 138**	**259 572**	**264 055**	**269 960**
Exports of goods and services	73 803	74 655	73 350	73 657	76 603	80 130
Consumption	147 114	147 522	147 482	147 600	148 094	149 469
private	102 470	102 580	101 865	101 896	102 194	103 318
public	44 644	44 940	45 603	45 690	45 885	46 138
Investment	42 610	41 544	39 493	38 042	38 944	40 055
private	35 378	34 194	31 862	30 410	31 304	32 387
public	7 232	7 348	7 623	7 621	7 630	7 660
Total demand	**265 921**	**264 112**	**260 698**	**259 228**	**263 705**	**269 602**

4. Financial balance of the Finnish economy

	2009	2010	2011	2012*	2013*
	% of GDP				
Gross investment	**22.8**	**21.9**	**22.2**	**22.3**	**21.2**
households and non-profit institutions	5.9	6.5	6.6	6.5	6.4
non-financial corporations and financial and insurance corporations	12.9	11.8	11.9	11.8	10.6
general government	4.0	3.7	3.8	4.0	4.1
Gross saving [1]	**23.3**	**23.1**	**22.1**	**20.4**	**18.9**
households and non-profit institutions	6.0	5.7	4.7	4.5	4.5
non-financial corporations and financial and insurance corporations	15.8	16.4	14.6	14.0	12.7
general government	1.4	1.1	2.8	1.9	1.7
Financial surplus	**2.1**	**1.5**	**-1.4**	**-1.8**	**-1.9**
households and non-profit institutions	-0.2	-1.1	-2.2	-2.3	-2.2
non-financial corporations and financial and insurance corporations	4.8	5.1	1.8	2.4	2.1
general government	-2.5	-2.5	-1.0	-2.1	-2.3
Statistical discrepancy	-0.1	0.0	0.0	-0.2	-0.5

[1] Incl. capital transfers (net).

5. Central government budgetary revenue by financial accounts and the Budget, EUR million

	Financial accounts			Budget		
	2011	2012	2013	2013	2014	2015 (proposal)
Income and capital taxes	11 021	10 775	11 075	11 795	11 153	11 409
Value-added tax	15 166	15 814	16 434	16 803	17 030	16 932
Excise duties	6 049	6 448	6 573	6 711	6 918	7 163
on tobacco	739	752	848	779	811	863
on alcoholic beverages	1 281	1 381	1 336	1 429	1 442	1 384
on fuels and energy	3 880	4 103	4 171	4 285	4 400	4 592
other excise duties	149	212	219	218	265	324
Motor car tax	1 067	1 007	932	1 034	997	993
Other taxes and similar revenue	3 012	3 277	3 726	3 580	3 695	3 546
Total taxes and similar revenue	**36 316**	**37 321**	**38 740**	**39 923**	**39793**	**40 043**
Miscellaneous revenue	4 723	6 065	5 137	4 936	4 745	5 997
Interest income and withdrawals of profits	2 043	1 925	2 030	1 922	1 995	2 783
Revenue before financial transactions	**43 082**	**45 311**	**45 907**	**46 781**	**46 533**	**48 823**
Redemptions of loans granted	160	423	264	252	402	415
Revenue before borrowing	**43 242**	**45 734**	**46 172**	**47 033**	**46 935**	**49 237**
Net borrowing and debt management	4 735	4 703	6 420	7 503	7 129	4 468
Total revenue	**47 976**	**50 437**	**52 591**	**54 536**	**54 064**	**53 705**

6. Central government budgetary expenditure by financial accounts and the Budget, EUR million

	Financial accounts			Budget		
	2011	2012	2013	2013	2014	2015 (proposal)
Pensions	3 823	4 043	4 229	4 244	4 366	4 472
Defence procurement	598	650	657	685	470	447
Other consumption expenditure	8 667	8 919	9 105	9 040	9 263	8 877
Total consumption expenditure	13 088	13 612	13 991	13 969	14 099	13 796
State aid to municipalities, etc.	11 456	11 991	11 776	12 233	11740	11157
State aid to industries	3 383	3 386	3 433	3 740	3612	3634
State aid to households, etc.	9 877	10 350	11 393	10 959	11493	12082
Transfers to extra-budgetary funds and the Social Insurance Institution	4 830	5 098	5 576	5 641	5709	5817
Other transfer expenditure	3 881	3 859	4 143	3 969	4 221	4 038
Total transfer expenditure	33 427	34 684	36 321	36 543	36 774	36 729
Acquisition of machinery, equipment, etc.	33	54	131	110	65	69
Building construction	41	43	79	69	59	50
Civil engineering construction	430	628	565	612	523	494
Total real investment	505	725	775	791	647	613
Interest on state debt	1 874	1 836	1 722	1 827	1 775	1 729
Miscellaneous expenditures	60	57	51	46	58	72
Total other expenditures	1 934	1 893	1 773	1 873	1 833	1 801
Expenditure before financial transactions	**48 954**	**50 914**	**52 860**	**53 176**	**53 353**	**52933**
Lending	720	1 042	1 084	1 049	505	650
Other financial investments	707	1 490	645	311	206	117
Total financial investment	1 427	2 532	1 729	1 359	711	767
Expenditure before redemptions	**50 382**	**53 446**	**54 587**	**54 536**	**54064**	**53 705**
Net redemptions and debt management	-	-	-	-	-	-
Total expenditure	**50 382**	**53 446**	**54 587**	**54 536**	**54 064**	**53705**

7. Government budgetary expenditure by administrative sectors in the financial accounts and the Budget, EUR million

	Financial accounts			Budget		
	2011	2012	2013	2013	2014	2015 (pro-posal)
21. Parliament	134	146	171	158	158	164
22. The President of the Republic of Finland	19	16	36	40	38	19
23. Cabinet Office	79	83	199	84	90	91
24. Ministry of Foreign Affairs	1 254	1 284	1 339	1 303	1296	1224
25. Ministry of Justice	852	887	883	870	899	901
26. Ministry of the Interior	1 312	1 293	1 356	1 317	1267	1219
27. Ministry of Defence	2 697	2 804	2 852	2 876	2750	2687
28. Ministry of Finance	15 609	17 415	16 991	16 982	17013	16950
29. Ministry of Education	6 666	6 541	6 605	6 656	6584	6769
30. Ministry of Agriculture and Forestry	2 770	2 678	2 641	2 723	2659	2661
31. Ministry of Transport and Communications	2 110	2 401	3 182	2 964	2970	2854
32. Ministry of Employment and the Economy	3 464	3 765	3 799	3 842	3376	3439
33. Ministry of Health and Social Affairs	11 176	11 990	12 498	12 593	12880	12756
35. Ministry of the Environment	332	279	299	261	271	204
36. State debt interest expenses	1 907	1 864	1 737	1 866	1814	1766
Overall expenditure	**50 382**	**53 446**	**54 587**	**54 536**	**54064**	**53705**

8. General government gross debt (EMU) [1)], EUR billion

	2012*	2013*	2014*	2015**	2016**
Central government	93.1	98.1	105.4	109.7	113.0
Local government	12.5	14.5	16.2	18.5	21.0
Social security funds	0.0	0.0	0.0	0.0	0.0
Total	**105.6**	**112.6**	**121.6**	**128.1**	**134.0**
% of GDP	53.0	55.9	59.6	61.2	62.1

[1)] Public debt is estimate by the Ministry of Finance also for years 2011, 2012 and 2013 due to the statistics revision. See box on page 70.

9. Social Insurance Institution, national pension fund

Revenue and expenditure in accordance with the Acts on National Pensions, Survivors' Pensions and Front-veterans' Pensions, EUR million

	2 009	2 010	2 011	2012	2013	2014[1]
Revenue						
Insurance contributions by employers	679	46	1	0	0	0
Central government contributions	2 614	3 377	3581	3659	3747	3 773
to national pensions	1 664	2 341	2345	2363	2386	2368
to child increments	4	6	6	6	6	6
to survivors' pensions	37	36	34	34	34	34
to guarantee pensions	.	.	124	155	158	157
to front-veterans' pensions	64	56	48	42	37	30
to child care allowances	369	390	420	442	466	492
to housing allowance for pensioners	70	70	72	75	79	84
to pensioners' housing allowances	32	31	32	33	34	35
to pensioners' care allowances	310	398	421	439	470	487
to dietary grants	7	7	8	8	9	9
to operating expenses	57	44	73	64	70	71
Yield on assets	27	26	15	7	21	2
Total	**3 320**	**3 449**	**3597**	**3667**	**3768**	**3 775**
Government guarantee payment	.	.	.	.	.	.
Additional government funding	130	.	.	.	.	.
Expenses						
Benefits	3 355	3 400	3505	3596	3680	3 699
National pensions	2 502	2 443	2385	2403	2425	2 407
pension-tested national pensions	2 459	2 401	2345	2364	2386	2368
child increments	6	6	6	6	6	6
survivors' pensions	37	36	34	34	34	34
Guarantee pensions	.	.	121	154	158	157
Front veteran's benefit	64	56	48	42	36	30
Housing allowance for pensioners	370	393	420	442	468	492
Disability benefits	419	509	532	555	593	614
care allowance for pensioners	310	401	421	440	471	486
child disability allowances	70	70	72	75	79	84
disability allowances for adults	32	31	31	33	34	35
dietary grants	7	7	8	8	9	9
Operating expenses	126	115	112	85	100	102
Total	**3 481**	**3 515**	**3617**	**3681**	**3780**	**3 801**

1) Estimate by the Social Insurance Institution.

10. Social Insurance Institution, national health insurance fund

Revenue and expenditure in accordance with the National Health Insurance Act, EUR million

	2 009	2 010	2 011	2012	2013	2014[1]
Revenue						
Insurance contributions	3 039	3 553	3 288	3 447	3 490	3 665
by beneficiaries	1 625	1 980	1 695	1 792	1 875	1 960
by employers	1 414	1 574	1 593	1 655	1 615	1 705
Retroactive payments	7	4	8	7	6	9
Special yield TÄMÄ RIVI POIS						
Yield assets	4	4	10	3	1	1
Central government contributions	1 190	1 293	1 260	1 319	1 230	1 295
Total	**4 240**	**4 854**	**4 566**	**4 776**	**4 728**	**4 970**
Expenditure						
Payments to beneficiaries [2]	3 526	3 591	3 718	3 824	3 791	3 932
daily allowances	809	826	851	863	857	877
maternity, paternity and parenthood allowances	970	1 023	1 055	1081	1105	1165
refunds on cost of medicines	1 245	1 226	1 262	1303	1273	1310
refunds on doctors' fees	198	194	198	199	199	202
refunds on examination and treatment expenses	70	72	76	79	64	66
refunds on transport expenses	235	251	276	298	294	312
Occupational health care charges	279	304	318	327	350	381
Rehabilitation	306	311	339	356	380	406
Other benefits	27	25	29	39	36	54
Contributions to the Farmers' Insurance Institution	10	8	9	9	9	10
Operating expenses	182	186	194	204	207	208
Total	**4 330**	**4 425**	**4 606**	**4 759**	**4 773**	**4 992**

[1] Estimate by the Social Insurance Institution.
[2] Also includes refunds disbursed through employers' health benefit schemes.

11. Social Insurance Institution, Social Security General Fund

Benefit and operating expenses disbursed by the Social Insurance Institution from sources other than the National Pension Insurance Fund or the National Health Insurance Fund as well as revenue, EUR million

	2009	2010	2011	2012	2013	2014[1]
Revenue						
Wage earners' unemployment insurance contribution	21	40	63	56	60	52
Central government contribution	3 811	4 014	4 033	4 418	4 775	5 071
Local government contribution	569	589	587	629	675	717
Other revenue	2	2	4	2	2	1
Total	**4 403**	**4 645**	**4 687**	**5 105**	**5 513**	**5 841**
Expenditure						
Basic unemployment allowances	975	1 097	1 134	1 421	1 683	1 915
Child benefits	1 437	1 433	1 436	1 490	1 493	1 495
Child day care subsidies	427	444	446	458	467	476
Maternity grants and adoption grants	11	11	11	11	11	12
Child maintenance allowances	70	102	102	112	186	191
Benefits for students	833	845	822	812	807	815
General housing allowance	482	530	552	606	670	727
Other benefits	48	50	51	52	54	59
Operating expenses	120	132	134	143	143	151
Total	**4 403**	**4 645**	**4 687**	**5 105**	**5 513**	**5 841**

[1] Estimates made by the Social Insurance Institution.

12 . Contributions. pension expenditure and technical reserves of private employment pensions institutions. EUR million

	2008	2009	2010	2011	2012	2013	2014[a]
Insurance contributions							
on wages[1]	10382	10030	10 417	11 200	11 900	12 100	12 500
on entrepreneurial income[2]	826	883	934	1 034	1 134	1 173	1 230
total	11208	10913	11 351	12 234	13 034	13 273	13 730
Pensions							
wage earners[1]	9124	10089	10 639	11 221	12 100	12 800	13 500
entrepreneurs[2]	1281	1391	1 450	1 533	1 640	1 740	1 820
- of which state contributions	510	578	598	574	605	650	680
total	10405	11480	12 089	12 754	13 740	14 540	15 320
Technical reserves at year-end (funds)	**70618**	**77000**	**80 733**	**80 456**	**84 000**	**88 000**	**91 000**
Contributions. % of GDP	6.1	6.3	6.5	6.5	6.9	7.2	7.5
Pensions. % of GDP	5.6	6.7	6.1	6.2	6.5	6.6	6.7
Average TEL-contribution. % of wages	21.1	21.3	21.6	22.1	22.8	22.8	23.6
Minimum yield requirement. %	5.50	3.0	4.00	4.63	3.62	4.37	4.75

Source: Eläketurvakeskus (The Finnish Centre for Pensions).

a) Estimate by the Finnish Centre for Pensions.

1) TyEL (Employees' Pensions Act) and MEL (Seamen's Pensions Act).

2) MYEL (Farmers' Pensions Act) and YEL (Self-Employed Persons' Pensions Act).

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MINISTRY OF FINANCE
Snellmaninkatu 1 A
PO BOX 28, 00023 Government
Tel. +358 295 160 01
Fax +358 9 160 33123
www.financeministry.fi

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