

# Budget review 2016



## **Budget review 2016**

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Economic Policy

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# Economic outlook

Recent trends in the global economy present a dual picture. Growth prospects in emerging economies have clearly deteriorated. In China, growth is expected to slow, partly because the country's movement towards becoming a more closed service-based economy has been faster than anticipated. The Russian economy is severely hampered by its inefficient production structure and by lowered raw material world market prices. Many of Finland's major trade partners, on the other hand, are seeing quite healthy growth. Growth is still fairly robust in both the United States and Germany, which are benefiting from a broad-based growth of economic activity. The Swedish economy is outperforming forecasts, although its growth is largely driven by strong domestic demand and service exports. Sweden's strong growth will therefore not significantly contribute to driving Finnish exports. Overall, global trade growth will remain very subdued over the next two years.

The difficulties of the Finnish economy are set to continue over the next couple of years. Growth prospects are poor, and the situation in public finances is showing no signs of substantial improvement. It is projected that in 2017, Finnish industrial output will be one-quarter lower than 10 years ago. Indeed, given the existing economic structure, the only chance for economic recovery is through a rebound in industry and manufacturing and exports. The growth forecast for 2016 is 1.2%. This growth will largely be driven by favourable private investment trends.

The labour market situation remains weak. Unemployment will rise clearly in 2015 from

last year, and the projected unemployment rate for 2015 is 9.4%. The number of the long-term unemployed has jumped to over 110,000, while the figure for the structurally unemployed has now exceeded 200,000. It is predicted that the number of employed people will also fall slightly in 2015. Although accelerating economic activity will bring an improvement to the employment situation in 2016, the unemployment rate is nevertheless expected to remain at 9.4 per cent due to an increase in the labour supply. At the same time the growth of household disposable real income will slow to 0.8% as a result of accelerating consumer prices.

Development of national economy						
December 2015 forecast						
	2012	2013*	2014*	2015**	2016**	2017**
GDP at market prices (EUR billion)	200	203	205	206	211	216
GDP, change in volume (%)	-1.4	-1.1	-0.4	0.2	1.2	1.2
Unemployment rate (%)	7.7	8.2	8.7	9.4	9.4	9.0
Employment rate (%)	69.0	68.5	68.3	68.1	68.5	68.8
Consumer price index (%)	2.8	1.5	1.0	-0.1	0.9	1.4
Long-term interest rate (10-year bonds) (%)	1.9	1.9	1.4	0.7	1.0	1.5

## Slow improvement in public finances

General government in Finland consists of central government, local government, earnings-related pension funds and social security funds, which are divided into earnings-related pension funds providing statutory pension insurance, and other social security funds.

Sluggish economic growth and economic restructuring, coupled with the growth in expenditure caused by population ageing, have driven Finland's general government finances into a state of permanent deficit. General

government finances will remain in deficit throughout the outlook period, even though the deficit will shrink in response to immediate spending cuts. General government debt to GDP will continue to rise to over 60 per cent.

General government deficit exceeded the 3 per cent reference value in 2014. However, the current estimate is that, during the outlook period, the deficit will fall somewhat below that threshold. Despite the sluggish economy, central government finances are gradually improving. This is above all attributable to the adjustment measures taken by the government. However, given the continued economic downturn, central government will remain deep in deficit over the next few years, even though the spending adjustments announced by the current government will help to reduce that deficit. The budgetary position of local government will also remain in deficit during the outlook period. Municipalities will continue their adjustment efforts and try to keep the growth in expenditure arising from the ageing population in check. The surplus from earnings-related pension funds will fall from 1.7 per cent of GDP last year to slightly over one per cent in 2015–2017. The increasing number of pen-

sioners and the higher average level of pensions will continue to drive up pension expenditure. The deficit of other social security funds has increased in recent years with continuing growth of unemployment expenditure. The deficit will begin to shrink this year as the unemployment insurance contribution collected from employers and employees is increased by one percentage point.

General government finances						
Key figures measured in terms of national accounting in ratio to GDP, percent						
	2012	2013*	2014*	2015**	2016**	2017**
Taxes and social security contributions (% of GDP)	42.7	43.8	43.9	44.6	44.5	44.2
General government expenditure (% of GDP)	56.1	57.6	58.2	59.1	58.7	58.3
Net lending (% of GDP)	-2.1	-2.5	-3.3	-3.3	-2.9	-2.6
— central government	-3.6	-3.6	-3.9	-3.1	-2.9	-2.7
— local government	-1.1	-0.7	-0.8	-0.9	-0.9	-0.8
— earnings-related pension funds	-2.4	1.8	1.7	1.2	1.1	1.1
— other social security funds	0.2	0.0	-0.3	-0.5	-0.2	-0.1
General government debt (% of GDP)	52.9	55.6	59.3	62.8	64.9	66.6
Central government debt (% of GDP)	42.0	44.3	46.4	48.5	49.9	51.3



# Government economic policy line

The objective of Prime Minister Juha Sipilä's Government is to bring the Finnish economy to a path of sustainable growth and increasing employment, and to secure the funding of public services and social security. The Government is committed to a restructuring programme that will promote employment, entrepreneurship and economic growth. Steps will be taken to improve conditions for business and incentives to work, coupled with investments in new opportunities for sustainable growth.

According to the Government Programme efforts to rebalance public finances will begin immediately. The growth of public debt to GDP will be halted by the end of the government term and no further debt will be incurred after 2021. During its term in office the Government is committed to making the savings and restructuring decisions that are necessary to cover the EUR 10 billion sustainability gap. The focus of taxation will be shifted from taxing labour and entrepreneurship towards environmentally and health motivated taxation. The total tax rate will not increase during the parliamentary term.

The Government has agreed on a consolidation programme to strengthen public finances. The measures under this programme cut across all sectors of society and will affect all people. At the same time, reallocations will be made to increase the guarantee pension, to improve child welfare and to strengthen society's internal and external security.

The Government will launch a reform programme to achieve the strategic objectives set for the government term. By the end of

2018, a one-off investment of EUR 1.6 billion will be made to support key government projects and to reduce the repair debt.

The Government was disappointed in its efforts to negotiate an inclusive social contract. Despite the collapse of these negotiations, the Government is determined to persist in its efforts to improve Finnish competitiveness, and announced a series of exceptional measures in September. The Government prepared a legislative package designed to improve the competitiveness of businesses by reducing unit labour costs by five per cent. The legislative package included changes to paid sick leave, the impact on working time of Epiphany and Ascension Day, the maximum length of paid annual leave, and limitations to the maximum amount of holiday bonus. A proposal will also be made in this respect for legal provisions concerning the employee's right to holiday compensation. The legislative package was returned from a consultation round on 9 December 2015, and preparations are now continuing with a review process. The Government is set to place the Bill before Parliament in February 2016.

## Fiscal policy rules

General government fiscal targets are governed by national and EU regulations, particularly the Growth and Stability Pact, which requires that Member States maintain structural balance in general government and avoid excessive deficits and government debt.

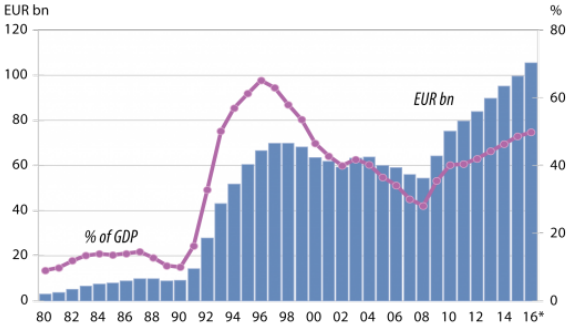
In 2014 the national accounts deficit in general government exceeded the 3 % thresh-

old set out in the Treaty on the Functioning of the European Union. The threshold will be exceeded in 2015 as well. According to the Ministry of Finance's December forecast the adjustment measures for 2016 decided by the Government, when implemented in full, will be enough to bring the general government deficit below the 3 % threshold in 2016. In other words Finland will be in compliance with the deficit criterion, as anticipated by the European Commission in June 2015. Finland's public debt will exceed the 60 % limit in 2015 and the debt criterion will be breached from 2016 onwards. However this does not in itself trigger an excessive deficit procedure.

Government policy is also informed by the medium-term objective (MTO) set for the structural balance of public finances, which is a deficit to GDP ratio of no more than 0.5 per cent. The Government has agreed on binding budgetary balance targets for individual general government sectors in order

to ensure that the MTO is met.

Central Government Debt



# Key projects



The Government Programme identifies five key strategic objectives. These are to strengthen employment and competitiveness; to develop knowledge and education; to promote health and well-being; to advance the bioeconomy and clean solutions; and to develop best practice solutions through digitalisation, experimentation and deregulation. These strategic objectives are furthered through key projects outlined in the Government Programme as well as through reforms to restructure the social and health care system, to reduce the tasks and obligations of municipalities, and to streamline regional administration.

In 2016–2018 the sum of EUR 1.0 billion will be invested in key government projects and EUR 0.6 billion in reducing the transport infrastructure repair debt.

## Financing for key projects:

- employment and competitiveness: EUR 170 million
- knowledge and education: EUR 300 million
- health and well-being: EUR 130 million
- bioeconomy and clean solutions: EUR 300 million
- digitisation, experimentation and deregulation: EUR 100 million

These key projects will be primarily financed out of revenue from dividends and sales of central government shareholdings. EUR 330 million of the required funding will be covered by reallocating funds that had been earmarked for the now postponed City Rail Loop project.

In 2016 investment in key government projects will amount to EUR 216 million, and EUR 100 million is earmarked for reducing the transport infrastructure repair debt.

*EUR 216 million in key government projects and EUR 100 million in reducing the repair debt in 2016.*

The pictures below provide some examples of investment in key government projects in 2016.

## EMPLOYMENT AND COMPETITIVENESS

- ▶ The Team Finland network will be strengthened by recruiting commercial and financial experts to work at selected diplomatic missions abroad, which will incur an additional cost of EUR 1.8 million in 2016.
- ▶ EUR 10 million will be spent on the capitalisation of Tekes Venture Capital, bringing total government investment to EUR 30 million. The aim is to promote the commercial application of research results.
- ▶ EUR 8.5 million is allocated in discretionary government transfers to support business internationalisation and to promote entrepreneurship.
- ▶ Additional funding of EUR 10 million is allocated to step up the digitisation of TE Office services, and EUR 5 million is made available to increase private employment services.
- ▶ EUR 9 million is allocated for the start-up of regional innovations and experiments.



## HEALTH AND WELL-BEING

- ▶ A total of 23.5 million will be invested in key health and well-being projects in 2016. These include service voucher and basic income experiments as well as an assessment of the effectiveness of housing-based social security.



## BIOECONOMY AND CLEAN SOLUTIONS

- ▶ EUR 30 million is earmarked for cleantech and bioeconomy solutions and for supporting the commercialisation of new innovations.
- ▶ EUR 20 million will be made available in investment aid for renewable energy and new energy technology projects.
- ▶ The budget for 2016 includes an allocation of EUR 11 million to the Fund for Agricultural Development (MAKERA), mainly earmarked for key projects aimed at the developing the bioeconomy and promoting the structural development of agriculture and increasing its competitiveness.
- ▶ Additional funding of EUR 11.4 million is allocated to key projects in natural resources economy in 2016. The purpose is to support the development of more diversified uses of wood, strengthen Finnish food production, accelerate the transition towards a circular economy, and promote the regeneration of fish stocks.
- ▶ A special grant for the VTT Technical Research Centre research infrastructure includes an additional authority of EUR 5 million for the development of high-quality research and pilot infrastructures in the bioeconomy field.
- ▶ Additional funding is made available to increase the recycling of nutrients, to develop the associated regulatory mechanisms and to protect the Baltic Sea and waterways. Furthermore, a new national park will be established to commemorate the centenary of Finnish independence in 2017. A national programme for the rehabilitation of contaminated land areas will also be launched as a key government project.



## KNOWLEDGE AND EDUCATION

- ▶ EUR 6 million will be made available in 2016 to accelerate the adoption of digital materials and to support digital learning experiments and development, plus EUR 8.5 million to support education and further training aimed at improving teachers' digital skills.
- ▶ The Academy of Finland's budget authority will be increased by EUR 30 million and Tekes funding by EUR 14 million in order to support projects aimed at strengthening business-academia cooperation and at facilitating the commercialisation of innovations.
- ▶ The Schools on the Move project will be rolled out across the country in order to encourage a minimum of one hour of physical exercise a day. Funding will be increased by EUR 7 million.
- ▶ The sum of EUR 1.5 million is allocated to developing and reforming processes and procedures in young people's services in social and health care in accordance with the youth guarantee scheme.



## DIGITISATION, EXPERIMENTATION AND DEREGULATION

- ▶ EUR 24,7 million is allocated to support the digitisation of public administration in 2016.
- ▶ EUR 5.9 million is earmarked for the creation of a national income register in 2016.





# Budget figures for 2016

## Budget appropriations and deficit

Appropriations for the 2016 budget amount to EUR 54.4 billion, which is EUR 0.5 billion more than the figure in the ordinary budget for 2015. Given the increase in price levels and the structural changes in the budget, appropriations for the different branches of government will increase in real terms by around 0.8 % from the ordinary budget for 2015.

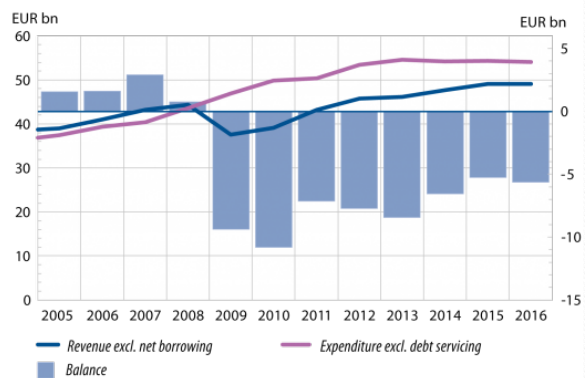
Among the factors contributing to increase the level of appropriations are the revision of the distribution of costs between central and local government, the increased costs due to unemployment, changes to the timing of Defence Forces materiel acquisitions, and investments in key projects. In addition, appropriations will be allocated to immigration services, where costs have risen following the increase in the number of asylum-seekers. The figure for appropriations take into account the adjustment measures announced in the Government Programme, which will reduce central government expenditure by a net total of over EUR 0.7 billion in 2016.

On-budget revenue for 2016, excluding net borrowing, is estimated to come in at around EUR 49.1 billion. The budget for 2016 shows a deficit of EUR 5.3 billion, which will be covered by increased borrowing. The deficit will increase by some EUR 90 million compared with the budgeted figure for 2015 (including supplementary budgets).

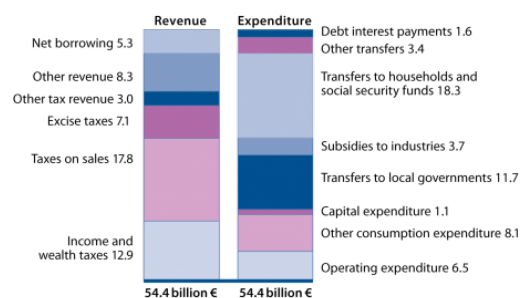
At year-end 2016 it is estimated that central government debt (including the debt of off-budget entities) will be around EUR 105 billion, or approx. 50 % of GDP.

*Central government debt will reach EUR 105 billion. Appropriations are EUR 54.4 billion, and revenue EUR 49.1 billion.*

Central government budget revenue, expenditure and balance



Central government budget revenue and expenditure in 2016, EUR billion



## Adjustment measures to curb borrowing



The Government Programme outlines a series of measures to reduce public expenditure and to increase revenue. These measures are foreseen to have a net consolidation effect of EUR 4 billion on public finances at an annual level in 2019. The effects of taxation changes are not included in this assessment. A more accurate picture has been gained of the effects of the proposed measures during the preparation of the budget, for example, the proposal included in the Government programme to replace pensioners' housing allowance with a general housing allowance was withdrawn and the expected savings were replaced by other savings. In addition, further savings decisions have been taken to help achieve the Government Programme's adjustment targets. The single most significant decision was to freeze the indexation of benefits paid out by The Social Insurance Institution of Finland, Kela as well as benefits tied to the cost of living index (excluding social assistance ) in 2017–2019.

The 2016 budget incorporates the savings, increases in fees and charges and some of the expenditure increases set out in the Government Programme, which will improve the balance of central government on-budget fi-

ances by a net total of over EUR 0.8 billion. The biggest expenditure savings at an annual level in 2016 include those coming from

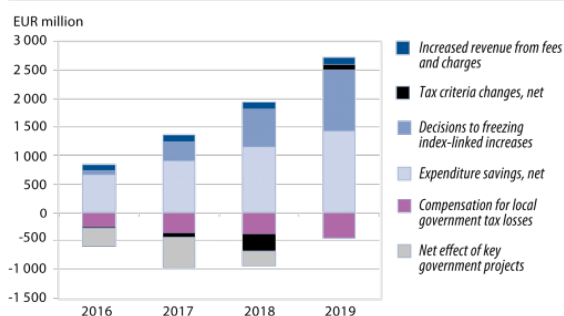
- indexations (– EUR 70 million),
- development cooperation (– EUR 200 million)
- health insurance reimbursements (– EUR 60 million),
- education, including early education and basic, upper secondary and higher education (– EUR 150 million),
- business and industry aid (– EUR 80 million),
- administration and ICT expenses (– EUR 50 million).

Selected expenditure savings in different administrative branches are described in a separate section below ('Excerpts from the budget').

The budget includes the following expenditure increases in line with the Government Programme

- internal security (+ EUR 50 million),
- Defence Forces' materiel procurements (+ EUR 50 million).

**Impact of adjustment measures during 2016-2019 parliamentary term on central government finances, EUR million**



At the start of the parliamentary term, the Government set the overall spending limits,

or a ceiling for budget expenditure during that term. The Government's first spending limits decision, the framework for the 2016–2019 term, is part of the 2016–2019 General Government Fiscal Plan, which was submitted to Parliament in connection with the 2016 budget proposal. Expenditure under the central government spending limits, at an annual level in 2019, will be EUR 1.3 billion lower than under the spending limits adopted on 2 April 2015. Appropriations in the 2016 State Budget foresee a reduced expenditure level in accordance with the spending limits decision.

## **Tax revenue**

On-budget revenue for 2016 (excluding net borrowing) is estimated at around EUR 49.1 billion, with tax receipts accounting for around 83 % or EUR 40.8 billion. Compared with the ordinary budget in 2015, it is estimated that on-budget revenue will decrease by some EUR 0.1 billion. This fall is explained by exceptional items included in the

2015 revenue forecasts, most notably one-off revenue from sales of shareholdings.

It is projected that tax revenue in 2016 will increase by 2 % or some EUR 0.9 billion compared with the 2015 budget. The development of tax revenue depends upon the development of tax bases and changes made to tax criteria.

The Finnish economy has seen no growth in three years. The Ministry of Finance's outlook expects the economy to move to slow growth in 2016. However, the sluggishness of the economy will continue to hamper tax base growth in 2016. Together with decisions already taken earlier, the proposed changes to tax criteria will increase central government tax revenue in 2016 by around EUR 0.4 billion at an annual level. In 2016 the tax increases announced in Prime Minister Sipilä's Government Programme will focus mainly on indirect taxes, at the same time as taxes on labour are reduced. Specific tax criteria changes are detailed below under the heading 'Excerpts from the budget'.

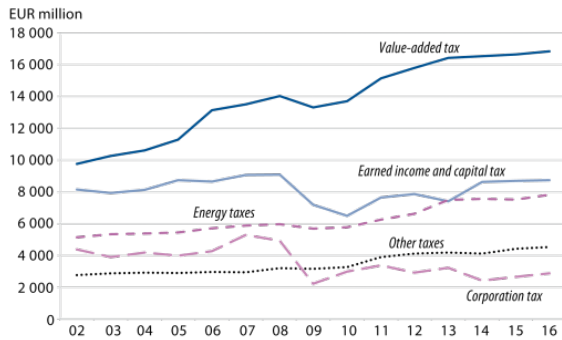
### Central government income tax scale in 2016

Taxable earned income, EUR	Tax at lower limit, EUR	Rate within brackets, %
16 700 - 25 000	8	6.5
25 000 - 40 800	547.5	17.5
40 800 - 72 300	3 312.5	21.5
72 300 -	10 085	31.75

### Value-added tax rates in 2016

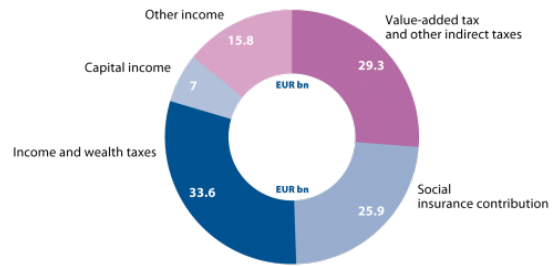
<b>General tax rate</b>	24 %
<b>Reduced tax rate</b> ▶ foodstuffs, animal feed and restaurants' food services	14 %
<b>Reduced tax rate</b> ▶ e.g. medicine, passenger transport, accommodation services, sports and recreation services, cultural services, books, newspaper and magazine subscriptions	10 %

### State tax revenue by tax type, years 2002-2016



### Where do tax euros derive from?

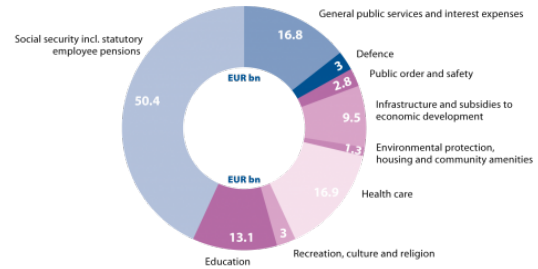
General government revenue in 2013: EUR 111.6 bn / 55.0 % of GDP (2012: 107.9 md. euro / 54.0 %)



SOURCE: Statistics Finland, National Accounts

### What are tax euros spent on?

General government expenditure in 2013: EUR 116.7 bn / 57.6 % of GDP (2012: EUR 112.2 bn / 56.1 %)



SOURCE: Statistics Finland, National Accounts

## **Social benefits and cost of public services**

### Selected monthly<sup>1</sup> benefits in 2016, part 1

	EUR/ month 2016	EUR/ month 2015
<b>Full national pension</b>		
<i>From 1 Jan. 2016</i>		
- living alone	634.30	636.63
- married	562.62	564.69
<b>Guaranteed pension</b>	766.85	746.57
<b>Child benefits</b>		
- 1 <sup>st</sup> child	95.75	95.75
- 2 <sup>nd</sup> child	105.80	105.80
- 3 <sup>rd</sup> child	135.01	135.01
- 4 <sup>th</sup> child	154.64	154.64
- 5 <sup>th</sup> child and each child thereafter	174.27	174.27
- single parent supplement per child	48.55	48.55
<b>Sickness insurance daily allowances</b>		
- minimum level for sickness, maternity, paternity and parental allowances	598.25	600.50

<sup>1</sup> Benefits granted on a daily basis are estimated on a monthly level.

### Selected monthly<sup>1</sup> benefits in 2016, part 2

	EUR/ month 2016	EUR/ month 2015
<b>Child home care allowance</b>		
- allowance for one child under three years of age	341.27	342.53 <sup>2</sup>
<b>Private childcare allowance</b>		
- allowance per child	173.74	174.64
<b>Partial child care allowance/parent</b>	97.73	98.09
<b>Basic unemployment security</b>		
- basic unemployment allowance	702.62	705.20
- labour market subsidy	702.62	705.20
<b>Student financial aid, maximum amounts</b>		
<i>Student grant</i>		
Higher education students		
- not living at home, under 18 year	147.52	147.52
- not living at home, 18 + years	303.19	303.19
Higher education students enrolling for the first time after 1 Aug 2014		
- not living at home, under 18 year	163.80	163.80
- not living at home, 18 + years	336.76	336.76
Other students		
- not living at home, under 18 year	101.74	101.74
- not living at home, 18 + years	250.28	250.28
<i>Student housing supplement</i>		
- 80% of established housing costs <sup>3</sup>	201.60	201.60
<i>State guarantee for study loans</i>		
- Higher education students	400.00	400.00

<sup>1</sup> Benefits granted on a daily basis are estimated on a monthly level.

<sup>2</sup> As of 1.8.2015 the grant is divided in half between parents.

<sup>3</sup> The allowance is not granted for the part of the monthly housing cost that exceeds EUR 252.

### Average expenses of selected public services in 2013

EDUCATION AND CULTURE	EUR	
basic education	8 780	/pupil
upper secondary education	7 585	/student
initial vocational education	11 845	/student
polytechnic education	8 005	/student
university education	9 900	/student
public libraries	3	/loan
SOCIAL SERVICES	EUR	
children's day care <sup>1</sup>	60	/day
old people's homes <sup>2</sup>	138	/day
HEALTH CARE SERVICES	EUR	
Basic health care		
- visit to health centre	89	/visit
- ward treatment	215	/day
- dental care	79	/visit
Special medical treatment		
- somatic special medical treatment <sup>3</sup>	1 151	/day

<sup>1</sup> Includes both day care centre and family day care costs and care days. Part-time and full-time day care costs have not been commensurated.

<sup>2</sup> Figure for 2013 is not fully comparable with earlier years because of the discontinuation of the Kainuu regional experiment. Figures for the municipalities in Kainuu are not included prior to 2013.

<sup>3</sup> Includes inpatient care and day surgery.

Sources: National Board of Education, Ministry of Education and Culture, National Institute for Health and Welfare and Statistics Finland.

Number of library loans: Suomen yleisten kirjastojen tilastot <http://tilastot.kirjastot.fi/>.

# Local government finances

## Central government transfers to local governments set to increase in 2016

Municipalities are responsible for the provision of a range of basic public services, such as education and social and health care. Funding for these services comes mainly out of local government tax revenue, which consists of municipal taxes (86 %), property taxes (8 %) and a share of corporate income tax revenue (6 %). Central government contributes to financing basic public services through a system of central government transfers to local governments. These transfers are determined by imputation and are universal, which means that local authorities can allocate the funds at their discretion. Furthermore, central government provides grants to municipalities for the performance of specific tasks and functions.

The central government transfer percentage illustrates the division of costs between central and local government. In 2016 the central government transfer percentage for basic public services in local government is 25.47. This means that local government accounts for 74.53 per cent of the funding needed for basic service provision. The central government transfer percentage for post-primary education financed by the Ministry of Education and Culture is 41.89.

In 2016 central government will be paying out a total of EUR 11 billion in transfers to local governments. This represents an increase of around EUR 0.4 billion on the figure for 2015.

In 2016 the level of central government trans-

fers to local governments will increase by EUR 256 million as a result of a revised division of costs between central and local government. The compensation of municipalities' tax losses will also increase the amount of central government transfers. Transfers to finance home help for families with children and child welfare will be increased by a total of EUR 10 million: this is intended to support implementation of the Social Welfare Act that took effect from the beginning of 2015. Central government transfers will be reduced by Government Programme measures designed to ease the cost burden of local governments. The subjective right to day care will be limited, and staffing levels in early childhood education revised. No index-linked increases will be made to central government transfers. Government transfers granted for purposes of reducing group sizes in basic education will be discontinued. In addition, some of the other transfers granted for the improvement of the quality of general education will be discontinued.

Local government tax revenue in 2016 is estimated to come in at around EUR 21.7 billion, about 0.5 % less than one year earlier. It is estimated that overall, cuts and increases to taxes on earned income will reduce local government tax revenue by a total of EUR 262 million. The central government transfer to support public service provision will be increased accordingly. The lower and upper tax limits of real estate tax rates will be raised, which is expected to increase local government tax revenue by EUR 25 million. The temporary increase in the share of corporate income tax revenue paid to local governments will be discontinued, which in annual terms

will reduce local government tax revenue by EUR 258 million. More detailed information on the 2016 tax criteria changes is provided under the section 'Excerpts from the budget'.

Local government finances will also be bolstered by the changes to service charges. Day care charges and fees for children's before and after school activities will be increased as of 1 August 2016, and charges for social and health care services will be increased from the beginning of the year.

It is estimated that the central government measures included in the budget will contribute to strengthen the financial position of municipalities by some EUR 240 million compared with 2015.

The balance in financing local government tasks and obligations is examined in more detail in the local government finance programme, which is compiled in connection with the general government fiscal plan.

## **Local government loan portfolio still increasing**

An imbalance has arisen between local government revenue and expenditure. Results for fiscal year 2014 were bolstered by incorporations of municipally owned enterprises, but in 2015 balance sheets will again show a deficit.

The estimate for local government finances in 2016 is a pressure projection that does not take into account municipalities' own adjustment efforts. The municipal tax rates have been held constant at 2015 level. The structural adjustment measures outlined in the Government Programme will strengthen local government finances by almost EUR 300 million in 2016. At the same time, however,

local government finances will be adversely affected by increasing service needs resulting from population ageing. Fiscal year 2016 will therefore remain in deficit.

Local government investment has increased sharply in recent years, and based on projected investment needs there is no significant change in sight in the immediate future. In 2016 the total loan portfolio held by the local government sector will increase to almost EUR 20 billion.

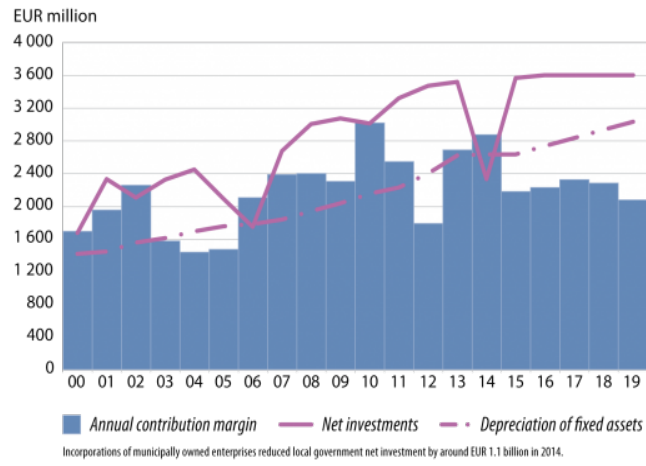
In national accounts terms the local government deficit was 0.8 % of GDP in 2014, and it is forecast to remain unchanged at this level over the next few years ahead.

## **Governance of local government finances strengthened**

The governance of public finances has been strengthened from the beginning of 2015. In its first general government fiscal plan in September 2015, the Government of Prime Minister Sipilä set the budgetary objectives for general government and its subsectors, including local government. In 2019 the local government deficit must not exceed 0.5 % of GDP. At the same time, the Government announced the measures it intended to put in place to achieve those objectives. The Government also specified a ceiling for local government expenditure to limit the pressures from central government measures on local government operating expenditure.



### Municipalities' and joint municipal authorities' annual contribution margin, depreciation & net investments



# Central government EU revenue and expenditure in 2014–2016



The European Council and Parliament reached an understanding on the EU budget for 2016 on 14 November 2015. The sum total of commitments to programmes within the multiannual financial framework is EUR 153 billion, while actual payments represent EUR 143.2 billion. The EU budget amounts to roughly 1 % of total EU GDP.

The EU budget is intended to boost innovation and growth, to create new jobs, to promote convergence among Member States and among regions, to support migration policy and to further strengthen the role of the EU as a global player. The budget also includes contributions to the European Fund for Strategic Investment (EFSI), which is central to the Investment Plan for Europe. Furthermore, the aim is to address payment

needs; to make progress towards a new Energy Union; to implement a forward-looking climate change policy; and to show administrative restraint.

The EU budget is financed in full from the community's so-called own resources. Own resources consist of traditional own resources (duties and levies on sugar production, approx. 13 %) and other own resources (pension contributions, interests, fines, surplus from previous year, approx. 1 %), payment of which to the EU comes without separate decisions by Member States, and the value added tax resource (approx. 13 %) and the gross national income resource (approx. 13 %), which come through the Member States' budgets.

Parliament and Council decisions concerning EU annual expenditure and revenue must fall within the seven-year financial framework.

The Finnish State Budget has been drafted on the assumption that the changes concerning own resources during the financial framework 2014–2020 shall take effect retroactively during 2016. This will bring an exceptional increase to Finland's annual membership contribution for 2016.

At central government level, Finland is expected to contribute an estimated EUR 1,996 million to the EU budget and the European Development Fund in 2016. Finland's contributions will be EUR 196 million higher than budgeted for 2015. Finland's share of the UK's EUR 5.3 billion budgetary rebate in 2016 is EUR 129 million.

Finland is expected to receive around EUR 1,187 million from the EU budget, which is EUR 103 million less than the projected figure for 2015. Rural development support is expected to decrease significantly toward

normal levels. The exceptionally high levels of support in 2015 are explained by the timing of payments following the start of a new EU programming period.

**Flow of payments between Finland and the EU 2014–2016**  
(EUR million)

CENTRAL GOVERNMENT EXPENDITURE	Final accounts 2014	Budget 2015	Budget 2016
<b>On-budget finances</b>			
VAT payment	284	274	280
GNI payment	1 562	1 396	1 542
Finland's share of the UK budgetary rebate	137	135	129
<i>EU PAYMENTS TOTAL</i>	<i>1 983</i>	<i>1 805</i>	<i>1 951</i>
European Development Fund	48	25	45
<b>TOTAL</b>	<b>2 031</b>	<b>1 830</b>	<b>1 996</b>
CENTRAL GOVERNMENT REVENUE	Final accounts 2014	Budget 2015	Budget 2016
<b>On-budget finances</b>			
Agricultural support	520	515	600
Rural development support	72	556	325
Subsidies from the structural funds and cohesion funds	216	114	120
Custom duties and other levies	42	46	34
Other revenue	31	40	92
<b>Off-budget finances</b>			
Intervention Fund of Agriculture	0	3	1
Fund for Agricultural Development	24	16	15
<b>TOTAL</b>	<b>905</b>	<b>1 290</b>	<b>1 187</b>
Customs duties, agricultural payments and sugar payments collected on behalf of EU	127	184	138

# Excerpts from the budget

## Taxation



### Taxes on earned income and capital income

- In accordance with the Government Programme, taxation on labour will be eased, particularly for low and middle incomes, by increasing the earned income tax credit by EUR 450 million in 2016.
- In earned income taxation, an adjustment corresponding to the change in the Index of Wage and Salary Earnings will be made at all income levels.
- The deductibility of mortgage interest expenditure will be further restricted, such that 55 % of mortgage interest expenditure is tax deductible in 2016.
- A capital loss will be made tax deductible from all capital income, whereas according to current legislation it is tax deductible only from capital gains.
- The validity of the Act on Withhold-

ing Tax for Taxation of Foreign Wage Earners with Special Expertise (so-called Key Individuals Act) will be extended.

- Donations between EUR 850 and EUR 500,000 from private individuals to universities or for purposes to promote arts or sciences, will be made deductible.
- The higher tax rate for capital income will be raised from 33 % to 34 %.
- As a result of the freezing of the so-called YLE-index, the Finnish Broadcasting Company (YLE) tax will be adjusted accordingly, such that the smallest amount of the tax to be paid is increased from EUR 51 to EUR 70. The lowest income limit at which the tax is levied will rise from around EUR 7,500 to around EUR 10,300 per year.
- The limit of the highest income bracket in the progressive income tax scale, the so-called solidarity tax will be lowered from EUR 90,000 to EUR 72,300 for 2016 and 2017.

### Corporate income tax

- The expiry at year-end 2015 of the temporary increase in the share of corporate income tax revenue paid to local governments, and the transfer of parishes' share of corporate income tax revenue to central government from the beginning of 2016, will increase central government's share of this revenue.

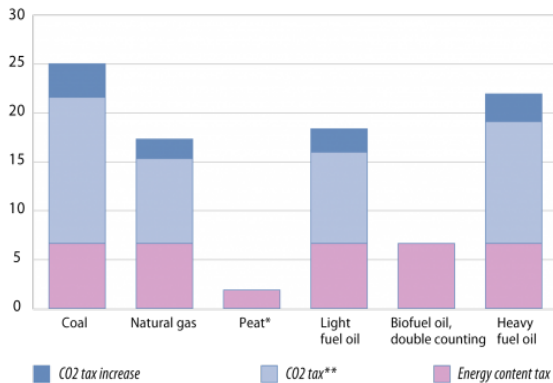
## Excise duties

- The tobacco tax will be increased twice in 2016. As a result of the tax increase it is estimated that revenue from the tobacco tax will increase by EUR 68 million a year.
- Taxes on heating, power plant and machinery fuels will be increased. It is estimated that this will increase central government tax revenue by a net annual total of EUR 75 million.

Excise duty amounts in 2015 and 2016			
	2015	2016	Tax changes %
	euros		
Average priced cigarettes (20)	3.70	4.15	12.2
Average priced rolling tobacco (30g pouch)	3.46	3.88	12.1
Light fuel oil, sulphur-free (100 litres)	18.74	21.40	14.2
Waste delivered to landfill (tonnes)	55.00	70.00	27.3
Base tax component of vehicle tax for average emissions car, 175 CO <sub>2</sub> g/km (€)*	170	231	35.9
per cent			
New average emissions car, 124 CO <sub>2</sub> g/km (% of price)	20.8	20.1	-3.4
New low emissions car, 95 CO <sub>2</sub> g/km (% of price)	15.7	14.4	-8.3

\* Previous government's decision

### Tax levels for energy products in 2016, €/MWh



\* Peat is not taxed according to energy content or CO<sub>2</sub> emissions as other energy products, but is subject to energy tax.

\*\* CO<sub>2</sub> tax is halved for CHP production.

- In accordance with the Government Programme, the annual vehicle tax will be raised so as to increase annual central government revenue by EUR 100 million as of 2017. Since vehicle tax is levied in advance for a 12-month tax period, the raise will generate additional tax revenue of about EUR 55 million in 2016.
- The increase in vehicle tax, which was decided in the previous parliamentary term, will increase central government tax revenue by about EUR 180 million as of 2016.
- The waste tax will be increased.
- The current estimate is that the unemployment insurance contribution will be increased by one percentage point. This increase will be divided equally between employers and employees.

## Other taxes

- As set out in the Government Programme, the car tax will be gradually lowered during 2016–2019. In 2016, tax revenue will decrease by approximately EUR 31 million.

## Other revenue

- Summary penal fees and day-fines will be increased; this is expected to generate a revenue of EUR 88 million.

## Appropriations



### Administration

Both the Government of Prime Minister Juha Sipilä and previous governments have announced operating expenditure cuts across all administrative branches. In 2016 these savings cuts amount to over EUR 300 million.

A unit charged with improving legislative impact assessment will be created under the Prime Minister's Office, with an allocation of EUR 0.25 million.

### Development cooperation

Appropriations for international development cooperation come to EUR 0.8 billion. This is estimated to represent 0.38 % of GNI in 2016. An appropriation of EUR 498 million is allocated for the Ministry for Foreign Affairs' development cooperation item, and EUR 140

million is earmarked for financial investments in development cooperation.

### Public order and security

Appropriations for public order and security will be increased by EUR 50 million as outlined in the Government Programme. Additional funds will be allocated, among others, to courts of law, the Criminal Sanctions Agency, the Police of Finland, the Finnish Border Guard, and Customs.

Support services for victims of crime shall be made available in compliance with the requirements of the EU Victim's Directive together with social and health care administration and non-governmental service providers.

Court fees will be raised and their scope of application extended as outlined in the Government Programme. The changes will be made in such a way that they do not undermine the legal rights of low income earners.

An appropriation of EUR 729 million is allocated to police operating expenditure. The Finnish Security Intelligence Service will be transferred from the National Police Board to the Ministry of the Interior from the beginning of 2016.

### Immigration

EUR 460 million, which is EUR 323 million more than in the ordinary budget for 2015, will be allocated to immigration administration and to the reception of refugees and asylum seekers. Central government compensation to local governments for immigrant integration measures amount to EUR 162 million; an increase of EUR 57 million from the ordinary budget for 2015.

The increasing number of asylum seekers is having a significant impact on immigration administration. In 2011-2014, the number of asylum seekers was steady at around 3,000-3,700 a year. The numbers started rising in late 2014 and have grown very rapidly during the summer and autumn of 2015. At the end of the year, the number of asylum seekers was approximately 32000. Given the difficulty of estimating the number of asylum seekers in 2016, the calculation of appropriations was based on an estimate of 15,000 asylum seekers, including the relocation of quota refugees and internal transfers of asylum seekers. Approximately 35 per cent of the asylum seekers are expected to be granted asylum. In 2016, the compensation paid to local governments is expected to cover approximately 21,000 asylum seekers. The number of quota refugees is unchanged at 750.

EUR 79 million has been allocated to the Finnish Immigration Service and state-run reception centres, which is EUR 49 million more than in the budget for 2015. A total of EUR 290 million has been allocated for the procurement of services for refugee and asylum seeker reception activities, or EUR 205 million more than budgeted in 2015. EUR 90 million is earmarked for subsidies and allowances paid to the customers of reception centres. The basic monthly allowance is expected to be EUR 316.07.

For the provision of integration training, language testing and competence assessment, an appropriation of EUR 83 million has been set aside for public employment services.

## **National defence and crisis management**

An appropriation of EUR 1.9 billion is allocated for Defence Force operating expenditure, slightly more than in 2015. A total of EUR 543 million is proposed for defence materiel acquisitions, EUR 126 million more than in the ordinary budget for 2015. This increase is mainly attributable to the deferral of payments for earlier acquisitions and the Government's commitment to step up investment in defence materiel by EUR 50 million in 2016. Furthermore, the budget includes an authorisation of EUR 314 million for purposes of improving the country's military defence capability.

Appropriations allocated for military crisis management take into account Finland's leading role in the UNIFIL operation in Lebanon: this role continues until 30 November 2016.

## **International organisations**

The budget recommends that authorisation be granted for initial subscription to the capital stock of the Asian Infrastructure Investment Bank (AIIB) at a total cost of USD 62 million in 2016-2020, and for payments on subscriptions to callable capital of USD 248.3 million based on AIIB membership.





## **Higher education institutions**

Higher education institutions shall improve their division of labour and so strengthen their profiles, as well as increase collaboration with one another and with research institutes. Functional and structural development within and between different sectors will be continued in order to pool skills and knowledge and to eliminate duplication and overlap. New efficiencies and the rationalisation of the higher education network mean that central government funding to higher education institutions will be reduced by EUR 75 million. In addition, index-linked increases to university and polytechnic funding will be discontinued in 2016–2019.

## **Financial aid for students**

Financial aid for students will no longer be index-linked. Parental income limits determining the eligibility of independently living secondary-level students aged 18–19 will be raised by 13 % as of 1 January 2016. The changes to the student financial aid system will enter into force in autumn 2016.

## **Youth and sport policy**

Every effort will be made to ensure continued delivery of youth workshop and outreach youth work services and at the same time to develop these services so that they better meet the needs of young people. These efforts are aimed at improving young people's life management skills and at reducing youth unemployment.

A further aim is to encourage a physically active way of life in the whole population and in this way to increase people's participation

and to promote the population's health and well-being. In addition, every possible support is given to the ethically sound practice of sport at the highest international level.

## **Arts and culture**

Revenue from betting and lottery accounts for 51% or EUR 233 million of total budget allocations to arts and culture. The Helsinki Central Library, one of the projects selected to commemorate the centenary of Finnish independence, will be supported with the sum of EUR 8 million. An appropriation of EUR 6 million is allocated to the renovation of the Suomenlinna service tunnel, EUR 4 million of which will be made available in 2016.

## **Agriculture and forestry**

The Government is committed to strengthen the vitality of rural areas and to create the conditions for diverse and competitive entrepreneurship and business growth. A further aim is to promote the structural development of agriculture and so to improve its productivity. A key instrument to this end is the rural development programme for mainland Finland 2014–2020 and the funding made available through this programme.

Conditions for primary food production and processing will be improved and steps will be taken to protect the health of people, animals and plants, to promote animal welfare and to create a more responsible food supply chain.

## Transport



EUR 505 million is earmarked for transport infrastructure investments. A total of EUR 1.1 billion is set aside for daily transport infrastructure maintenance. Out of this sum EUR 100 million is part of the Government's investment in key projects and in reducing the transport infrastructure repair debt. The Helsinki railway yard development project will be launched in 2016 to minimise disruptions to commuter and long-distance rail services in the Helsinki region and elsewhere in Finland, and to increase the capacity of the railway yard.

Public transport subsidies will be reduced by EUR 15 million. EUR 10 million of this will be reallocated to purchases of long-distance rail services.

## Employment policy



The budget allocates an appropriation of EUR 2.85 billion for unemployment security, an increase of around EUR 100 million to the ordinary budget for 2015, which is mainly attributable to the growth of unemployment.

The appropriation for public employment and business services is EUR 585 million, up by EUR 21,5 million from the 2015 ordinary budget. This is due, among other things, to the adjustment measures announced by the current and previous governments, the weaker employment situation and the growing need for integration training caused by an increase in the number of asylum-seekers.

The criteria for eligibility to job alternation leave will be tightened to create annual savings of around EUR 50 million in general government expenditure. Central government savings will come to around EUR 10 million.

## Energy policy

The budget proposes an appropriation of EUR 235 million for subsidies to renewable energy production, an increase of EUR 21 million from 2015. The growing need for funding is due to the increased wind power capacity and the reduced tax on fuel peat.

## Social benefits and health insurance reimbursements

Child allowances will no longer be index-linked.

Savings on health insurance reimbursements will be achieved by reducing reimbursements for travel expenses as well as reimbursements for medical and dental care. Expenditure on discretionary rehabilitation services will be reduced by cancelling the planned AURA rehabilitation programme.

Savings on pharmaceutical expenses will be delivered by introducing an annual initial amount of medical expenses that the individual will be required to pay in full: eligibility for health insurance reimbursements will start beyond that level of prescription drug purchases. In addition a range of other measures will be introduced to curb the growth of pharmaceutical expenses.

The diet allowance will be discontinued from the beginning of 2016. This will deliver savings of EUR 10 million.

Income limits and reimbursement rates for the determination of sickness and parenthood allowances will be revised. The earned income limit for eligibility to a 70% sickness allowance will be lowered, and the increased component of parenthood allowance for the first 30 days of parental leave will be reduced. Furthermore, holiday entitlements accrued during periods of parental leave will be limited.

## Pensions paid by central government



EUR 4.7 billion is earmarked for the payment of pensions and compensations by central government under the Ministry of Finance main title of expenditure. EUR 4.5 billion is allocated to pensions under the Ministry of Social Affairs and Health main title of expenditure. National pensions totalling EUR 2.3 billion and guarantee pensions of EUR 192 million will be financed by the state. In addition, EUR 645 million will be spent on farmers' pensions, EUR 123 million on self-employed persons' pensions, EUR 59 million on seamen's pensions and EUR 15 million on farmers' occupational accident pensions.

A monthly increase of EUR 23 in guarantee pensions will generate a cost impact of EUR 30 million in 2016.

## Veterans

The budget foresees spending EUR 236 million on supporting war veterans. This appropriation takes into account the changes in disabled veterans' incapacity criteria for eligibility to municipal outpatient services: the threshold degree of incapacity is lowered from 20 % to 15 %. The cost effect amounts to EUR 5 million in 2016. The war veterans' re-

habilitation appropriation will be increased by around EUR 319 per veteran compared with 2015.

## **Nature and the environment**

The Forest Biodiversity Programme for Southern Finland (METSU), the Natura 2000 network and other nature conservation programmes agreed upon earlier will be continued within the constraints of resources available. Appropriations for the acquisition of nature conservation areas and for compensation paid to landowners will be reduced by EUR 20 million in line with the Government Programme. The budget allocates an appropriation of EUR 38 million for the public administrative duties associated with Metsähalitus' nature services. This includes the sum of EUR 8 million allocated to the completion of the conservation measures in areas already

designated as nature conservation sites.

## **Housing**

Municipalities in the Helsinki metropolitan area can be granted temporary start-up assistance of up to EUR 10 million with a view to increasing state-subsidised rental housing production. The authorisation for interest subsidies to state-subsidised social housing production is EUR 1,170 million, for loan guarantees EUR 285 million, and state guarantees for housing companies' renovation loans EUR 100 million. The majority of state-subsidised housing production shall be concentrated in major growth centres, particularly the Helsinki region.

EUR 25 million is earmarked for renovation assistance. Most of this will go to financing repairs in the homes of old and disabled people and to the retrofitting of lifts.

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