MINISTRY OF FINANCE

Budget review 2018

Review of budget proposal, September 2017

Ministry of Finance publications – 33c/2017

Economic Policy

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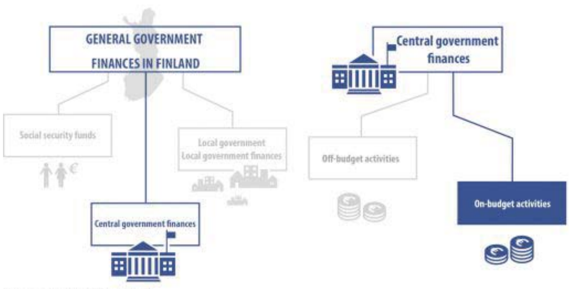
1 Introduction

General government finances in Finland consists of central government, local government and social security funds. Central government finances include the central government budget economy i.e. the on-budget activities and off-budget activities (the off-budget activities are discussed in chapter 8 Extra-budgetary central government finances of the budget proposal). The position of central government on-budget activities in central government finances and general government finances is illustrated by diagram 1. This publication is mainly concerned with the central government on-budget activities. The Government's budget proposal for 2018, which will be submitted to Parliament in September, is the topic of examination. The purpose is to provide a concise description of the main themes of the central government budget with the help of diagrams and tables as well as to guide the reader to explore the themes in more detail via Internet links. The background materials for budgeting include the independent economic forecasts produced by the Economics Department at the Ministry of Finance, which are presented in the Economic Survey.



Source: tutkibudjettia.fi (translation)
Diagram 1. Central government finances as part of the general government finances and the on-budget activities as part of the central government finances

The central government budget is a plan concerned with the central government's finances and financial management prepared on the basis of the General Government Fiscal Plan published in the spring. In practice, the central government budget evaluates the extent and allocation of central government revenue and expenditure for the following year. The Government negotiates on the budget proposal in the budget session.

In Finland, the Parliament has the prime decision-making authority on the use of central government resources. The Parliament primarily exercises its power in two ways: by enacting laws and approving budgets. The majority of the content of the budget is bound by law and, indeed, laws are often amended before making decisions on the budget. The Parliament approves the budget for the following budget year before the end of the previous budget year.

The Government Programme defines the Government's main economic policies, which serve as the basis for preparing the budget. At the beginning of the parliamentary term, the Government also decides on the spending limits for the parliamentary term, i.e the central government's expenditure ceiling, and the rules for the spending limits procedure. At the same time, the spending limits set the outline for the entire expenditure during the four-year parliamentary term. The spending limits' allocation for each administrative branch is reviewed within the parliamentary term spending limits in April as part of the General Government Fiscal Plan, and updates the spending limits to correspond to changes to the level of costs, prices and spending limit expenditure structure. For more information, see http://vm.fi/en/central-government-spending-limits.

The final sum of the budget proposal for 2018 is EUR 55.7 billion. Most of the appropriations will be spent on social security, and business and industry. Revenue will be primarily collected in taxes based on turnover, such as value-added tax, and income taxes, including earned income and capital income tax. The central government on-budget deficit is predicted to amount to EUR 3 billion and central government debt is expected to rise to approximately EUR 110 billion.

The following chapter includes an overview of the economic outlook in the areas of real economy and general government finances. Chapter 3 is concerned with the Government's economic policy goals and their implementation. Chapter 4 includes revenue and expenditure estimates, deficit and debt in the central government budget proposal. Local government and regional finances are also discussed from the viewpoint of the on-budget activities. Chapter 5 includes a summary of the review.

2 Economic outlook

The economic review of the Ministry of Finance deals with the economic outlook at the national and international level as well as economic policy and general government finance.

Real economy

The economy of Finland is projected to grow by approximately 2.1% in 2018. The deceleration of growth compared to the growth rates of 2.9% in 2017 largely results from private consumer demand, as growth in purchasing power is slower than in that year. Acceleration in inflation to 1.5 per cent will reduce the purchasing power of wage-earners even though the enhanced employment situation supports growth in this area. Investments will increase at a faster rate compared to 2017 and investments in construction will continue to grow rapidly. The growth of Finland's gross domestic product will improve employment and the number of unemployed people will slowly decline. The unemployment rate is predicted to edge downwards to 8.1 per cent, while the employment rate is expected to rise to 70 percent in 2018. Key forecast figures for 2015–2018 have been compiled in

Table 1. Trends in the national economy 2015–2018, September 2017 forecast

	2015*	2016*	2017**	2018**
GDP at market prices (EUR bn)	210	216	224	232
GDP, change in volume (%)	0.0	1.9	2.9	2.1
Unemployment rate (%)	9.4	8.8	8.6	8.1
Employment rate (%)	68.1	68.7	69.4	70.1
Consumer price index, change (%)	-0.2	0.4	0.9	1.5
Interest rate (10 year bonds) (%)	0.7	0.4	0.5	0.9

* Advance information
** Forecast

General government finances

Table 2 presents key indicators for general government finances for 2015–2018. The table reveals that the deep deficit of general government finances has been gradually reducing. General government finances have been strengthened by the consolidation measures imposed by the Government as well as the economic growth emerging last year. Regardless of the positive economic turn, general government finances will remain in deficit in 2018. Moreover, due to the ageing of the population, there will be a significant imbalance between revenue and expenditure in the general government finances in the longer term.

The problems in general government finances are structural and the nominal general government debt will continue to grow. General government debt has increased significantly during the previous eight years. Over the next few years, the growth rate of the nominal debt will slow down and the debt relative to GDP will be reduced.

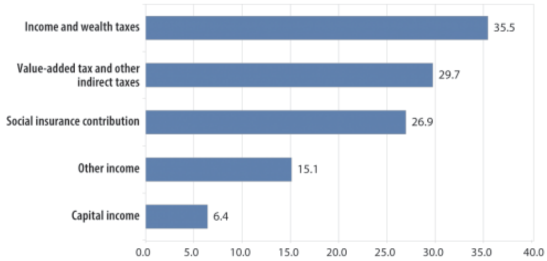
Table 2. Key figures measured in terms of national accounting in ratio to GDP, percent, General government finances, September 2017 forecast

	2015*	2016*	2017**	2018**
Taxes and social security contributions, % of GDP	44.0	44.1	43.2	42.2
General government expenditure, % of GDP	56.9	55.8	54.1	53.1
Net lending, % of GDP	-2.7	-1.8	-1.2	-1.4
- central government	-3.0	-2.7	-2.3	-2.0
- local government	-0.6	-0.4	-0.1	-0.3
- employment pension schemes	1.3	1.1	0.8	0.7
- other social security funds	-0.4	0.2	0.3	0.2
General government debt, % of GDP	63.6	63.1	62.5	61.9
Central government debt, % of GDP[1]	47.6	47.5	47.7	47.5

* Advance information
** Forecast

1) The estimate of central government debt by the Economics Department of the Ministry of Finance differs from that estimated based on the budget, for instance, due to updated revenue forecasts

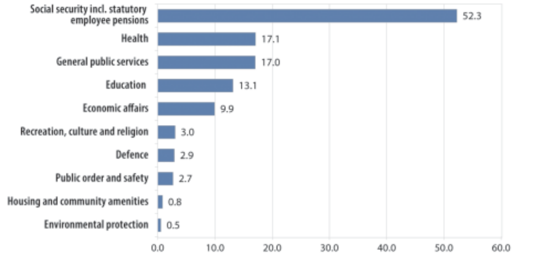
In addition to economic cycles, the structures of general government finances are also reflected on the revenue contributions to general government and the allocation of expenditure. Diagram 2 illustrates that the majority of general government revenue was collected as income or wealth tax, and as indirect tax, in 2015.



Source: Statistics Finland

Diagram 2. General government revenue in 2015, EUR bn

Most of the general government expenditure is comprised of social security benefit expenditure as illustrated by Diagram 3. This expenditure includes pensions, unemployment benefits, benefits aimed at families as well as housing allowance during illness and allowances preventing social exclusion.



Source: Statistics Finland, National Accounts

Diagram 3. General government expenditure by function (COFOG) in 2015, EUR bn

Table 3 illustrates the average extent of the costs resulting from education and culture as well as social welfare and health care services. For example, the table reveals that the costs per student of vocational education and training for general government finances were the highest compared to other forms of education in 2015.

Table 3. Average expenses of selected public services in 2015

	EUR	
Education and culture		
basic education	8,955.0	/pupil
upper secondary education	7,749.0	/student
initial vocational education	11,503.0	/student
polytechnic education	7,788.0	/student
university education	9,344.0	/student
public libraries	3.6	/loan
Social services		
children's day care[1]	59.1	/day
old people's homes	152.2	/day
Health care services		
Basic health care		
- visit to health centre	83.6	/visit
- ward treatment	254.9	/day
- dental care	85.8	/visit
Special medical treatment		
- somatic specialised medical treatment[2]	1,065.2	/day

1) Includes part-time and full-time day care financed by municipalities. Days of part-time care are also included in the days of care. The costs for 2015 have been calculated using the price index of the costs of 2014 and the general government expenditure.
2) Includes inpatient care and day surgery

Sources: National Board of Education, Ministry of Education and Culture, National Institute for Health and Welfare, Sotkanet.fi, Finnish Public Libraries Statistics and Statistics Finland

3 Government economic policy

Prime Minister Sipilä's Government determines its economic policy in the Government Programme (http://valtioneuvosto.fi/en/sipila/government-programme). The Government's objective is to raise Finland's economy on to a path of sustainable growth and rising employment, and to secure the funding of public services and social security. The objective is to bring living on debt to an end in 2021, increase the employment rate to 72 per cent and the number of people in employment by 110,000.

The Government aims to cover the EUR 10 billion sustainability gap through actions instantly enhancing the general government finances, measures supporting growth and employment, and reforms strengthening general government finances. The immediate consolidation measures in accordance with the Government Programme have been recorded in the central government spending limits and are included in the budget proposal for 2018. The budget proposal also includes new measures for promoting employment in addition to the previously determined actions. The Government supports employment, e.g. by removing incentive traps, continuing the development of employment services and unemployment security as well as ensuring that taxation on earned income will not be increased. The focus of taxation will be shifted from taxing labour and entrepreneurship towards environmentally and health motivated taxation.

In addition to the debt target, the Government has set targets for the general government budgetary position related, on one hand, to the budgetary position of central government, local government and the social security funds during the parliamentary term and, on the other hand, to the combined structural budgetary position of general government in the medium term. Table 4 describes these objectives and rules that guide Finland's fiscal policy, and compares them with the forecast by the Ministry of Finance. The table illustrates that we are yet far from the goal when it comes to central government finances. Social security funds are close to their target and it appears that the objective set for the financial standing of the local government will be met.

Table 4. Objectives and rules steering Finland's fiscal policy

Public finance sector	Variable	Target for 2019: % GDP	Forecast for 2018: % of GDP
Government's budgetary targets for the parliamentary term			
Central government	Deficit	no more than 0.5 %	-2.00 %
Local government sector	Deficit	no more than 0.5 %	-0.30 %
Social security funds			
- Earnings-related pension funds	Surplus	approximately 1.0 %	0.70 %
- Other social security funds	Financial standing	approximately 0.0 %	0.20 %
General government finances	Debt	debt-to-GDP ratio in 2019 < in 2018	61.90 %
EU rules			
General government finances	Deficit	3.00 %	-1.40 %
	Debt*	60 %	61.90 %
	Medium-term budgetary objective (MTO) for structural budgetary position**	-0.50 %	-1.30 %

* The interpretation of the EU's debt rule also takes into account e.g. the speed of debt reduction in the past and the future.

** Under the Stability and Growth Pact, EU Member States are obligated to set a medium-term budgetary objective (MTO) for the structural deficit of general government finances. The structural deficit of 0.5% in ratio to GDP has been set as Finland's MTO. The Government aims to reach the MTO in 2019. More information in chapter 3 on the general rationale of the budget proposal.

Finland's general government fiscal targets are also governed by EU regulations, most significant of which is the Stability and Growth Pact, which requires that Member States maintain structural balance in general government finances and avoid excessive debt.

4 Budget proposal 2018

Central government revenue and expenditure are examined in the general rationale of the budget proposal in chapters 4 and 5 as well as in the detailed rationale (www.budjetti.vm.fi, in Finnish or Swedish). The revenue estimates are presented by department and the appropriation estimates by administrative branch.

4.1 **Revenue, expenditure, deficit and debt**

Revenue

In 2018, central government on-budget revenue (excluding net borrowing) is estimated to be approximately EUR 52.7 billion, with tax revenue accounting for approximately 83 %, i.e. EUR 44.0 billion. Tax revenue is estimated to grow by 4.4% in 2018. Diagram 4 examines only the development of tax revenue between 2004 and 2018. The diagram demonstrates that, during the previous decade, the focus of central government taxation has been shifting increasingly towards indirect taxes and that e.g. certain excise taxes and energy taxation have been increased on several occasions. On the other hand, the impacts of tax criteria changes on the tax revenue have been dampened by the modestly developed tax base.

Diagram 4. State tax revenue by type 2004–2018, EUR million

Expenditure

The allocation of appropriations, i.e. central government expenditure, to different purposes depends on political decisions, economic structures and economic cycles. In 2018, a significant share of the appropriations of the central government budget proposal will be allocated to social security (36%). Diagram 5 illustrates where Finland will allocate its appropriations in accordance with the Government proposal in 2018.

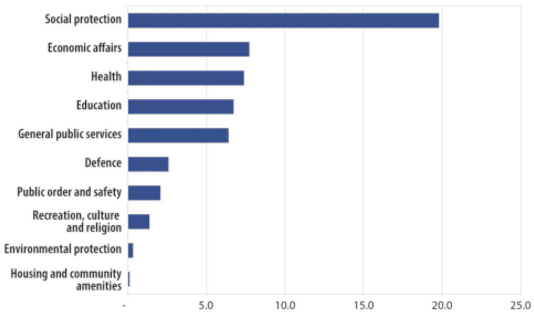


Diagram 5. Budget appropriations in 2018 by function (COFOG), EUR bn

Compared to the previous budget, there is growth of around 0.3% in the expenditure in 2018. Based on the expenditure categories presented in Diagrams 5 and 6, only expenditure on social protection, defence and health care will increase. Despite the decrease in unemployment-related expenses, social security expenditure will grow by some 2%, which is also illustrated by Diagram 6. Factors contributing to this development include the expansion of the general housing allowance as well as the continuation of rapid growth in costs resulting from the Health Insurance Act and pension expenditure. The transferral of students to within the scope of the general housing allowance will reduce expenditure on education and transfer it to expenditure on social security in the context of this review. The reduction of health insurance contributions by employers in connection with the Competitiveness Pact will raise central government expenditure arising from the Health Insurance Act. The growth in health care expenditure can be explained by the increase in resources related to the preparation and implementation of the health, social services and regional government reform, which in this category is technically defined as part of health care expenditure.

The sharpest fall in expenditure occurs in relation to housing and community amenities at approximately 5%. However, the Diagrams show only the expenditure of the budget. Most of the expenditure to support housing production is funded from the off-budget Housing Fund. In addition, direct housing allowance is included in social security expenditure. This means that the budget expenditure on housing and community amenities is only 0.2% of the total expenditure and the overall impact of the decrease on the budget expenditure will remain minor. More significant factors reducing the total expenditure include the decline in resources allocated to the promotion of business and industry despite the fact that more funds are spent on the development and maintenance of transport infrastructure compared to the previous year.

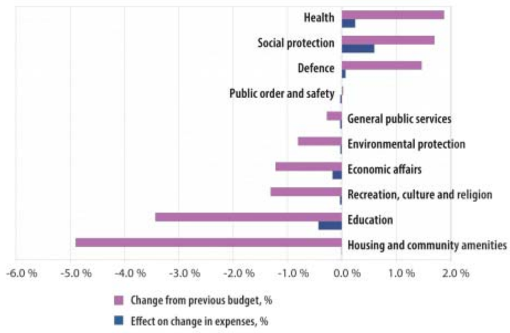


Diagram 6. The percentage change in appropriations by function and effect on the percentage change in expenditure

Part of the revenue in the central government budget are obtained from the European Union, while, on the other hand, Finland also makes contributions to the EU. At central government level, Finland is expected to contribute around EUR 2.0 billion to the EU budget and the European Development Fund in 2018. Finland's contributions will be EUR 85 million higher than the contributions in the 2017 Budget. Finland is expected to receive approximately EUR 1.2 billion from the EU budget, which is EUR 101 million less than the projected figure for 2017. The relationship between EU revenue and expenditure in the central government finances is illustrated in Table 5. In accordance with the budget proposal of the EU for 2018 provided by the European Commission on 30 May 2017, EU funding will be allocated to addressing challenges related to migration and the situation with refugees, improving the security of the citizens of EU Member States, and additional contributions related to strategic investments and sustainable growth.

Table 5. Flow of payments between Finland and the EU 2016–2018, EUR million

Central government expenditure	Final accounts 2016	Budget 2017	Budget 2018
On-budget finances			
VAT payment	280	285	285
GNI payment	1,309	1,488	1,564
Finland's share of the UK budgetary rebate	129	130	139
EU PAYMENTS TOTAL	1,717	1,903	1,988
European Development Fund	53	54	54
Total	1,770	1,957	2,042
Central government revenue	**Final accounts 2016**	**Budget 2017**	**Budget 2018**
On-budget finances			
Agricultural support	538	545	536
Rural development support	397	310	320
Subsidies from structural funds and cohesion funds	137	170	240
Customs duties and other levies	39	31	36
Other revenue	71	22	47
Off-budget finances			
Intervention Fund of Agriculture	0	0	0
Fund for Agricultural Development	0	0	0
Total	1,183	1,078	1,179
Customs duties, agricultural payments and sugar payments collected on behalf of the EU	124	124	144

Deficit

The budget proposal for 2018 shows a deficit of EUR 3 billion, which will be covered by increased borrowing. The deficit will decrease compared with the figure budgeted for 2017 (taking into account already approved supplementary budget). In national accounting terms, the central government deficit for 2018 is expected to be approximately 2.0 % in ratio to GDP. Central government on-budget activities have shown a deficit since 2009. The situation is illustrated in Diagram 7.

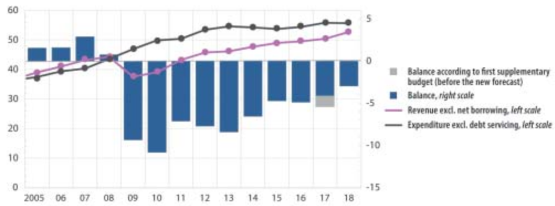


Diagram 7. Central government budget revenue, expenditure, and balance 2005–2018, EUR billion

Debt

At the end of 2018, central government debt (including debt of off-budget entities) is expected to be approximately EUR 110 billion, which is approximately 47% in ratio to GDP. Diagram 8 illustrates that central government debt has more or less doubled during the previous ten years.

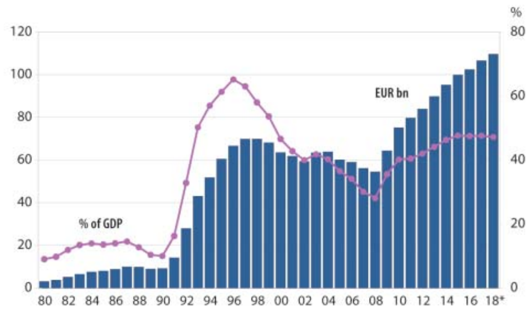


Diagram 8. Central Government Debt 1980–2018

4.2 Excerpts from tax and allocation decisions in budget proposal 2018

TAX CRITERIA CHANGE

In 2018, the Government will continue to reduce taxation to compensate on the increase in wage and salary earners' contributions. Taxation of labour will be reduced by EUR 300 million. Earned income tax criteria will also be alleviated to correspond with the change in the consumer price index in 2018. The validity of the fixed-term reduction of the minimum level of the solidarity tax will be continued. The fixed-term child deduction will expire at the end of 2017. The reduction in the deductible proportion of mortgage interest will be continued in accordance with the Government Programme. The structure of the public broadcasting tax will be changed based on a proposal by a parliamentary working party so that those on the lowest incomes will be exempt from the tax.

The tax on alcohol will be raised by EU 100 million. The energy taxes on transport fuels and heating and power plant fuel are raised by EUR 45 million net.

The tobacco tax will continue to be raised in stages in 2018 and 2019. In 2018, the tax will be raised by EUR 68 million. Vehicle taxation will be reduced in total by some EUR 182 million in years 2016–2019. The suspension of the rail goods transport tax and the halving of fairway dues will be continued until the end of 2018.

The central government will compensate municipalities for the impact of the reduction of early childhood education and care costs which weakens local government finances. The total compensation amounts to EUR 110 million.

GENERAL PUBLIC SERVICES

EUR 6.8 million are proposed to be paid to the Prime Minister's Office for costs resulting from Presidency of the Council of the European Union in 2018. Finland will hold the Presidency of the Council of the European Union from 1 July to 31 December 2019.

EUR 0.6 million is proposed for the arrangements for the year of remembrance of the Finnish Civil War 1918 and the preparations and coordination of the centenary of the flag of Finland (29 May 2018). The Finland 100 project will be utilised in preparing and carrying out the celebrations.

EUR 1 million is proposed for the development of electronic service channels for financial and debt counselling in 2018.

For the preparation of the health, social services and regional government reform, an appropriation of EUR 181 million is proposed for the launch of county government, establishment of service centres, and support for ICT changes. EUR 100 million in appropriations is proposed for the implementation of the freedom of choice pilots of the health and social services reform in 2018. For more information, see 4.3.2.

An addition of EUR 15.9 million for election expenditure is proposed for the preparations to the county elections in October 2018.

DEFENCE

An increase of EUR 50 million is proposed for the operating costs of the Finnish Defence Forces for the purpose of improving preparedness required by changes in the security environment and EUR 2 million for hiring contractual military personnel.

It is proposed that EUR 8 million more be allocated to military crisis management compared to the actual budget for 2017. The addition is primarily due to the continuation of the training operation in Iraq.

PUBLIC ORDER AND SAFETY

An increase of EUR 44 million is proposed for police appropriations for purposes such as safeguarding operations, increasing equipment and gear, enhancing operative performance and capacity to prevent cybercrimes, and preventive work against terrorism.

An increase of EUR 6 million is proposed for the Finnish Security Intelligence Service for the purpose of enhancing capacity due to new threats and changes in the operating environment.

An increase of approximately EUR 11 million is proposed to the Border Guard appropriations for purposes such as improving internal security, equipment procurement and checks performed at external borders, for instance due to the increase in external border traffic at Helsinki Airport.

An additional appropriation of EUR 0.3 million is proposed for the Emergency Services College for increasing the education volume for emergency response centre operators.

To enable faster processing of appeals on asylum decisions and getting rid of long waiting times for the processing of the appeals, an additional EUR 1.49 million is proposed for the supreme administrative court and EUR 2.2 million for other courts of law. Additional funding of approximately EUR 0.5 million is proposed for legal aid for asylum seekers.

An increase of EUR 0.4 million is proposed for improving the operating conditions of the prosecution service in preventing terrorist crimes and implementing criminal justice.

An additional EUR 0.4 million is proposed for the Criminal Sanctions Agency for the purpose of preventing violent radicalisation and activities by fundamentalist movements in prisons.

ISSUES RELATED TO BUSINESS AND INDUSTRY

An additional EUR 25 million is proposed for the employment services for the implementation of an activation model for unemployment security.

An additional EUR 5 million is proposed for the Ohjaamo one-stop guidance activities related to the Youth Guarantee and EUR 3 million for constructing psychosocial support services for young people in connection to the Ohjaamo service points.

Business Finland, which will begin its operations at the beginning of 2018, will join the services related to innovation funding, export, investments and tourism promotion of Tekes and Finpro under one roof.

EUR 35 million is proposed for the capitalisation of Finnish Industry Investment Ltd. The appropriation is intended for establishing the FoF Growth Fund III (Kasvurahastojen rahasto III) in line with a Government key project, which will make market-based investments in capital investment funds investing in Finnish growth companies.

An addition of EUR 20 million is proposed in authorisation for energy subsidies. The appropriation reserved for renewable energy production subsidies will increase by EUR 40.7 million. A Government proposal on banning the use of black coal in energy recovery will be prepared in 2018. Additional appropriation totalling EUR 7 million is proposed for circular economy investments, developing growth ecosystems and promoting innovative procurement.

EUR 5 million is proposed for the payment of regional transport subsidy.

EUR 8 million is proposed for the renewal of the vehicle stock and the promotion of low-emission traffic through the continuation of the scrapping incentive programme. An additional annual allocation of EUR 6 million is proposed to support the acquisition of vehicles that operate solely on electricity and the conversion of gas and flexfuel vehicles. The construction of a recharging and distribution network, the process of electrification for logistics in built-up areas and public passenger transport in urban regions will also be supported.

The appropriation for rural development is proposed to grow by EUR 41 million primarily due to the progress of the implementation of the Rural Development Programme as well as the appropriation reserved for interest subsidy expenditure.

In total EUR 8 million in additional funding is proposed for the implementation of the Tourism 4.0 key project. The purpose is to allocate funding to tourism marketing, improvement of digital competence in travel companies and development of the availability of services around the year.

It is proposed that approximately EUR 25 million in appropriations be reserved in 2018 for new transport infrastructure projects, including the Ring Road I at Laajalahti, the Vuosaari and Kokkola fairways and the ride arrangements on the Western Metro extension.

ENVIRONMENTAL PROTECTION

An additional appropriation of EUR 8 million is proposed for the protection of old forests (Forest Biodiversity Programme for Southern Finland, METSO).

EUR 2 million is allocated to wood construction.

An increase of EUR 0.85 million is proposed for reviving migratory and endangered fish stocks (fish passages).

EDUCATION

Early childhood education and care fees will be reduced by EUR 70 million beginning on 1 January 2018. In 2018–2019, an extensive pilot project will be launched on free early childhood education and care for five-year-olds. EUR 5 million of funding is proposed for the project.

An additional appropriation of EUR 25 million is proposed for enhancing equality in comprehensive schools. It is proposed that EUR 5 million be allocated to strengthening the instruction in natural sciences and mathematics.

Additional funding of EUR 15 million is proposed for the implementation of the reform of vocational education and training. The provision of vocational training will be increased by 1,000 student-years in order to ease youth unemployment and to address skills needs. The increase in appropriations proposed for this is EUR 9.4 million.

Students transferred to within the scope of the general housing allowance on 1 August 2017.

A parent supplement will be introduced to the financial aid for students taking care of a child under 18 years of age. This will result in a need for additional appropriation of EUR 10 million.

SOCIAL SECURITY incl. earnings-related pensions

Due to the growing volume of pension expenditure and related index adjustments, an addition of EUR 117 million is proposed for the pensions and compensation paid for by the central government

It is expected that unemployment benefit expenditure will decline by EUR 168 million, e.g. as the unemployment rate is projected to fall. The activation model for unemployment security is expected to reduce the expenditure on unemployment security by EUR 9.5 million in 2018. On the other hand, the aim is to amend the Unemployment Security Act so that people on unemployment security will be able to launch business activities. Using unemployment security for short-term studying will also be made easier. Additional appropriations of EUR 10 million and EUR 3.5 million are proposed for these purposes.

An increase of just over EUR 14 million is proposed for pay subsidies in 2018. Young people will also be directed from the Employment and Economic Development Offices to services offered by, for instance, private service providers. Service providers will be paid on a results basis, which means payment will be based on the extent to which young people progress towards training or work. The target for this performance-based procurement is set at 10,000 young people below the age of 30, which will bring the estimated costs to EUR 15 million.

EUR 8 million a year is proposed for raising minimum allowances, i.e. sickness allowance, parental allowance, rehabilitation allowance and special care allowance.

An appropriation of EUR 9.5 million is proposed for raising the amount of the single-parent supplement of the child benefit. EUR 1.7 million is proposed for the purpose of raising maternity grant.

Adjusting housing costs based on the cost-of-living index instead of the rent index has been taken into account in the housing allowance. Maximum housing costs will also be frozen and a partial housing norm will be introduced. These reforms will reduce housing allowance expenditure by around EUR 28 million next year. At the same time, basic subsistence expenditure will increase by EUR 11.6 million.

EUR 18 million is proposed for increasing the guarantee pension and EUR 10 million is proposed for increasing the basic rate of the care allowance for pensioners in 2018.

An additional appropriation of EUR 4 million is proposed to ensure the availability of shelter places.

Next year, it is proposed that new central government compensation for municipalities be introduced for the urgent social welfare costs of individuals living in the country illegally. Appropriation of around EUR 5.3 million is proposed to be reserved for this purpose.

EUR 1 million will be allocated for the prevention of economic problems of people living in rental housing.

4.3 Local government finances and the regional government reform

The central government funds the operations of municipalities with central government transfers and discretionary government transfers provided through the government aid system. Central government cannot directly influence the expenditure in municipalities; instead, this is governed by legislation set by the Parliament and the decisions made by the municipalities. The local government finances programme and chapter 7 of the general rationale of the budget proposal describe the state of local government finances and the impact of central government measures on local government finances in further detail.

4.3.1 Local government finances: revenue, expenditure and financial standing

In 2018, the revenue of municipalities is expected to comprise of tax revenue (53%), operating income (22%), central government transfers (20%) and other revenue (4%). It is estimated that 48% of municipalities' expenditure will be allocated to wages and salary, 33% to procurement of services and materials, 11% to investments and 8% to other expenditure. Distribution of municipalities' revenue and expenditure is illustrated in Diagram 9.

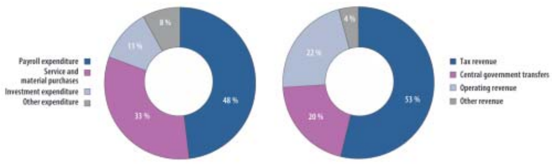
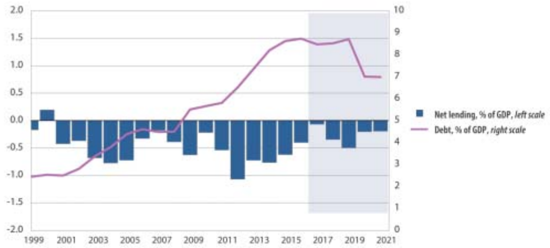


Diagram 9. Distribution of municipalities' revenue and expenditure in 2018, %

Based on the Government's budgetary targets for local government finances, local government net lending (on a National Accounts basis) may not exceed -0.5 per cent in ratio to GDP in 2019. Based on current forecasts, this goal will be reached in 2019. In 2018, the deficit of the local government sector is estimated to be -0.3% relative to GDP and debt is projected to stand at 8.4%. The development of deficit and debt is illustrated in diagram 10. More information on this issue is available in chapter 2.4 of the Economic Survey of the Ministry of Finance.



Source: Statistics Finland, Ministry of Finance

Diagram 10. Net lending and debt in the local government sector, % of GDP

Central government measures affect the revenue and expenditure of municipalities. The net impact of the central government measures will weaken local government by around EUR 129 million in 2018. The weakening is due above all to statutory adjustment to the division of costs between the central government and municipalities. The impacts are transferred to municipalities as changes to the tasks, operations and funding of the municipalities decided by the Parliament. The adjustment to the division of costs between central government and municipalities as well as the centralisation of specialised medical care are the most significant measures. The impact of central government measures on municipalities has been analysed in further detail in chapter 7.3 of the general rationale of the budget proposal and chapter 4.2 of the local government finances programme.

4.3.2 Health, social services and regional government reform

The preparation of the health, social services and regional government reform will continue in 2018. The aim is to establish counties beginning on 1 June 2018, at which point the temporary county government will begin its work. The first county council elections will be held in October 2018 and the county councils will begin their operations at the latest in January 2019. The responsibility for the provision of social welfare and health care services and management of the duties of other administrative branches will be transferred to the counties beginning in 2020.

Approximately EUR 181 million in central government budget financing is reserved for the preparations for the implementation of the reform in 2018. The financing will cover the costs of advance preparations and the temporary government, planning and implementation of national information systems, and establishment of the counties' joint service centres. The financing will be used to realise regional and national change management as well as the preparations of the implementation required by the reform also in the Government.

5 Summary

This publication examines the budget proposal for 2018.

The main objectives of the Government include bridging the sustainability gap in general government finances and increasing the employment rate. The goal is to bring living on debt to an end in 2021. The Government Programme includes different consolidation measures. The focus of taxation will be shifted from taxing labour and entrepreneurship towards environmentally and health motivated taxation.

The economy is expected to grow in 2018. The unemployment rate is projected to decline and the employment rate to increase. Nevertheless, the employment situation will recover moderately and there will be a considerable sustainability gap, i.e. an imbalance between revenue and expenditure, in general government finances in the long term due to the ageing of the population.

The total sum of the budget proposal for 2018 exceeds EUR 55.7 billion. The central government on-budget deficit is predicted to amount to approximately EUR 3 billion and central government debt is expected to rise to approximately EUR 110 billion.

The budget proposal for 2018 includes investments in, for instance, the support for employment, preparation of the health, social services and regional government reform, freedom of choice pilots in health care, the police and defence as well as the promotion of business and industry. It is expected that unemployment benefit expenditure will decline as a result of the improving employment situation.

The budget proposal for 2018 will also be updated on the www.tutkibudjettia.fi website which allows examining the budget visually from different viewpoints.

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