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OF FINANCE

Budget review 2021

Review on central government budget proposal,
October 2020

Economic Policy

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Abstract <p>The present publication examines the budget proposal for 2021, which will be submitted to Parliament in October. The aim is to provide a concise description of the central themes of the 2021 Budget. The budget proposal is based on an independent economic forecast of the Economics Department at the Ministry of Finance, which is presented in the Economic Survey.</p> <p>During the first half of 2020, the ongoing coronavirus pandemic reduced the Finnish economy less compared to most European economies. The economy will gradually recover from the sudden halt occurring in the first half of 2020. GDP is expected to grow by 2.6 % in 2021. In 2021, the number of employed people will continue to slightly decrease, resulting in the projected employment rate of 71.0%.</p> <p>The economic downturn triggered by the coronavirus outbreak and the measures to contain its impacts have substantially boosted Finland's general government deficit in 2020. General government finances will not return to the pre-pandemic levels when the downturn is over. The economic growth expected in the coming years will not be enough to balance the general government budgetary position and Finland's general government finances will remain substantially in deficit.</p> <p>The appropriations in the budget proposal for 2021 amount to EUR 64.2 billion. The central government on-budget deficit is expected to be around EUR 10.8 billion, and central government debt is expected to rise to around EUR 135 billion. Temporary increases in expenditure related to the coronavirus situation will lead to higher expenditure. The expenditure will also be higher due to issues such as the increase in unemployment expenditure, statutory and contractual index increases, the central government wage agreement, and additional, previously decided investments, such as the estimated expenditure impacts of the purchase of HX fighter aircraft.</p>			
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Tiivistelmä <p>Tässä julkaisussa tarkastellaan vuoden 2021 talousarvioesitystä, joka annetaan eduskunnalle lokakuussa. Tarkoituksena on tarjota tiivis kuvaus valtion budjetin keskeisistä teemoista vuonna 2021. Talousarvioesitys pohjautuu valtiovarainministeriön kansantalousosaston riippumattomaan talousennusteeseen, joka esittelee Taloudellisessa katsauksessa.</p> <p>Maailmanlaajuinen koronaviruspandemia on supistanut alkuvuonna 2020 Suomen taloutta vähemmän kuin suurinta osaa Euroopan talouksista. Talous toipuu alkuvuoden 2020 pysähdyksestä asteittain. Vuonna 2021 BKT:n ennakoitaan kasvavan 2,6 %. Työllisten määrä supistuu vuonna 2021 vielä hieman, jolloin työllisyysasteeksi ennakoitaan 71,0 %.</p> <p>Koronavirusepidemiasta seurannut talouden taantuma ja epidemian haittojen vähentämiseksi tehdyt toimet ovat kasvattaneet julkisen talouden alijäämää vuonna 2020 huomattavan paljon. Julkinen talous jää taantumaan jälkeen heikompaan tilaan kuin ennen epidemian alkua. Lähivuosina näkyvissä oleva talouskasvu ei riitä vahvistamaan julkisen talouden rahoitusasemaa ennalleen, ja julkinen talous pysyy selvästi alijäämäisenä.</p> <p>Vuoden 2021 talousarvioesityksen määrärahat ovat 64,2 mrd. euroa. Valtion budjettitalouden alijäämäksi ennakoitaan noin 10,8 mrd. euroa ja valtionvelan odotetaan nousevan noin 135 mrd. euroon. Menotasoa nostavat koronavirustilanteeseen liittyvät määräaikaiset menonlisäykset. Lisäksi menotasoa korottavat muun muassa työttömyysmenojen kasvu, laki- ja sopimuserusteiset indeksikorotukset, valtion palkkatarkaisu sekä jo aiemmin päätetyt lisäpanostukset, kuten HX-hävittäjähankinnan arvioidut menovaikutukset.</p>			
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Referat <p>I denna publikation granskas budgetpropositionen för 2021, som lämnas till riksdagen i oktober. Avsikten är att ge en kort beskrivning av centrala teman i statsbudgeten 2021. Budgetpropositionen baserar sig på en oberoende ekonomisk prognos från finansministeriets ekonomiska avdelning, och den presenteras i den ekonomiska översikten.</p> <p>Den globala coronaviruspandemin har i början av 2020 minskat Finlands ekonomi i mindre utsträckning än de flesta de europeiska ekonomierna. Ekonomin återhämtar sig stegvis från avbrottet i början av 2020. År 2021 beräknas BNP växa med 2,6 %. Antalet sysselsatta minskar ytterligare en aning 2021, varvid sysselsättningsgraden beräknas ligga på 71,0 %.</p> <p>Den ekonomiska recessionen till följd av coronavirussituationen och de åtgärder som vidtagits för att minska skadorna av epidemin har avsevärt ökat underskottet i de offentliga finanserna 2020. De offentliga finanserna kommer efter recessionen att befinna sig i ett svagare läge än före epidemin. Den ekonomiska tillväxt som kan skönjas under de närmaste åren räcker inte till för att återställa saldot i de offentliga finanserna och de kommer därför att uppvisa ett tydligt underskott.</p> <p>Anslagen i budgetpropositionen för 2021 uppgår till 64,2 miljarder euro. Statens budgetekonomi beräknas uppvisa ett underskott på cirka 10,8 miljarder euro och statsskulden beräknas stiga till cirka 135 miljarder euro. Utgiftsnivån höjs av tidsbundna utgiftsökningar som anknyter till coronavirussituationen. Vidare stiger utgiftsnivån till följd av bland annat ökningen i arbetslöshetsutgifter, lagstadgade och avtalsbaserade indexförhöjningar, statens löneuppgörelse samt de tilläggssatsningar som regeringen beslutat om redan tidigare, såsom de uppskattade utgifterna på grund av HX-jaktplansprojektet.</p>			
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1 Introduction

General government finances in Finland consist 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 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 central government on-budget activities. The Government's budget proposal for 2021, which will be submitted to Parliament in October, is examined in the present review. Its 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 budget proposal is based on an independent economic forecast produced by the Economics Department at the Ministry of Finance, which are presented in the Economic Survey.

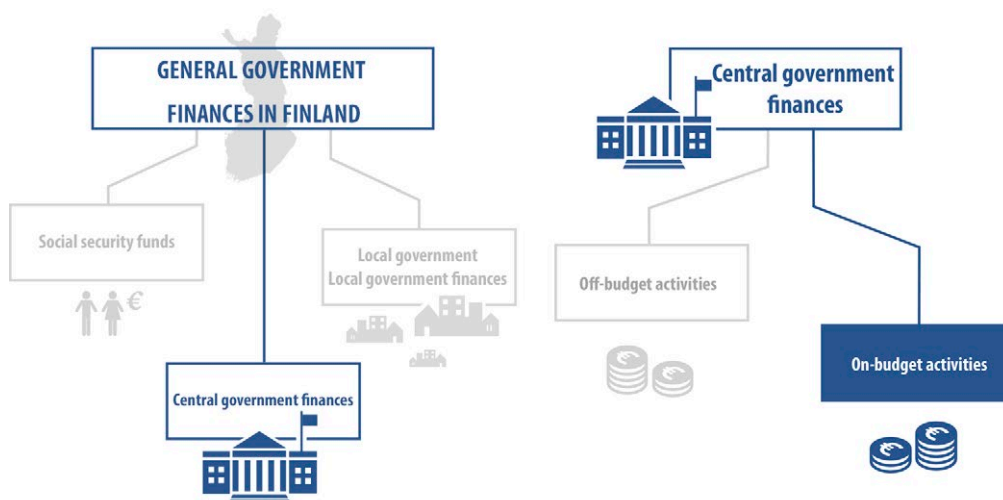


Diagram 1. Central government finances as a part of the general government finances and the on-budget activities as a part of the central government finances

Source: tutkibudjettia.fi (translation)

In Finland, Parliament has the highest decision-making authority on the use of central government resources. 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. Parliament approves the budget for the following budget year before the end of the previous one.

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 as well as the Programme of Prime Minister Marin's Government. 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.

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 allocations for each administrative branch made within the spending limits are reviewed by the Government in April as part of the General Government Fiscal Plan, and the spending limits are updated to correspond to changes in the level of costs, prices and spending limit expenditure structure. For more information, see <https://vm.fi/en/central-government-spending-limits>.

The final sum of the budget proposal for 2021 is EUR 64.2 billion. The highest share of the appropriations will be spent on social security. 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 10.8 billion and central government debt is expected to rise to approximately EUR 135 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 attainment. Chapter 4 includes revenue and expenditure estimates, deficit and debt in the central government budget proposal. Local government finances are also discussed from the viewpoint of the on-budget activities. Chapter 5 gives a summary of the review.

2 Economic outlook

The Economic Survey 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.

2.1 Real economy

The contraction caused by the coronavirus pandemic in the Finnish economy in the first half of the year was less severe than in most other European economies in 2020. The economy will start picking up at the end of 2020 but the recovery will be slow because of growing uncertainty and weak confidence among economic actors.

Finland's gross domestic product is expected to contract by 4.5% in 2020. In addition to the exports, private consumption and private investments will also decrease. Higher public spending will support economic growth. Employment will contract by 2% and the employment rate will fall to 71.2%. Decrease in employment and the large number of layoffs will increase the unemployment rate to 8 per cent.

The economy will gradually recover from the sudden halt occurring in the first half of 2020. GDP is projected to grow by 2.6% in 2021. While the consumption of goods is expected to return to its normal level in 2021, cautiousness among consumers is expected to continue to affect the consumption of services. Fall in housing construction is slowing down the recovery of investments. Exports and industrial production have been hit by the continuation of the pandemic, but growth will resume in 2021. In 2021, the number of employed people will continue to slightly decrease, resulting an employment rate of 71.0%.

A higher level of economic activity and employment will probably lead to higher wage drifts in 2021, and nominal earnings will increase by 2.5%. However, uncertainty about future economic developments will be reflected on inflation in the coming years.

Table 1. Trends in the national economy 2018–2021

October 2020 forecast	2018*	2019*	2020**	2021**
GDP at market prices (EUR bn)	233.7	240.6	232.6	242.2
GDP, change in volume (%)	1.5	1.1	-4.5	2.6
Unemployment rate (%)	7.4	6.7	8.0	8.2
Employment rate (%)	71.7	72.5	71.2	71.0
Consumer price index, change (%)	1.1	1.0	0.4	1.2
Interest rate (10 year bonds) (%)	0.7	0.1	-0.2	-0.1

*Advance information

**Forecast

2.2 General government finances

The economic downturn triggered by the coronavirus outbreak and the measures to contain its impacts is substantially increasing Finland's general government deficit in 2020. General government finances will not return to the pre-pandemic levels when the downturn is over. The economic growth expected in the coming years will not be enough to balance the general government budgetary position and Finland's general government finances will remain substantially in deficit.

The structural factors weakening the sustainability of general government finances have not disappeared but will have a permanent impact irrespective of economic cycles. Ageing of the population has already increased pension expenditure as well as care and treatment costs and this trend will continue in the coming decade and beyond. The sustainability gap in general government finances remains unsolved.

Most of the funding for the support measures prompted by the coronavirus situation comes from central government. The fiscal policy of 2020 is highly expansionary. Central government deficit will shrink from 2021 onwards as the economy starts growing and most of the support measures will come to an end.

The situation in local government will remain difficult. The local government budgetary position is burdened by the growing need for health and social services and expenditure as the population is ageing. While the current recession will reduce tax revenue, central government will strongly support local government finances due to the coronavirus situation, especially in 2020.

The surpluses accumulated by employment pension institutions will be wiped out almost completely in 2020 as the employment pension contribution is temporarily lowered and the rising unemployment is reducing contribution income. Surpluses of the employment

pension institutions will also remain around 0.5% in the coming years as pension expenditure continues to grow and low interest rates slow down growth in the institutions' property income.

The financial position of the other social security funds is weakened by large-scale layoffs, rising unemployment and the temporary extension of the unemployment security. Decrease in the number of layoffs and the increase in the unemployment insurance contribution will ease the situation of other social security funds in 2021.

The general government debt-to-GDP ratio is now rising rapidly: in 2020 it will increase by over ten percentage points, to about 70%. The sudden rise in the debt ratio is caused by the contraction of GDP and especially by a huge increase in central government deficit. The debt ratio will reach over 75% by the year 2024.

The most important risks now facing general government finances are closely connected with overall economic developments. At the same time, a second wave of the pandemic, growing uncertainty and the reintroduction of extensive restrictions could slow down the economic recovery and weaken general government finances. Moreover, general government contingent liabilities and especially the rapid rise in guarantees will pose a risk for general government finances.

Table 2. Key figures measured in terms of national accounting in ratio to GDP, percent

September 2020 forecast, % of GDP	2018	2019*	2020**	2021**
Taxes and social security contributions	42.4	42.2	41.9	42.7
General government expenditure	53.4	53.3	59.8	57.6
General government net lending	-0.9	-1.0	-7.7	-5.0
- central government	-1.2	-1.2	-7.2	-4.4
- local government	-0.9	-1.1	-0.4	-1.0
- employment pension schemes	1.0	1.1	0.1	0.4
- other social security funds	0.2	0.3	-0.2	-0.1
General government debt	59.6	59.2	70.2	72.8
Central government debt ¹⁾	44.9	44.2	53.3	55.6

* 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 in the accrual of general government revenue and the allocation of expenditure. Diagram 2 illustrates how the majority of general government revenue was collected as income or wealth tax, and as indirect tax, in 2018.

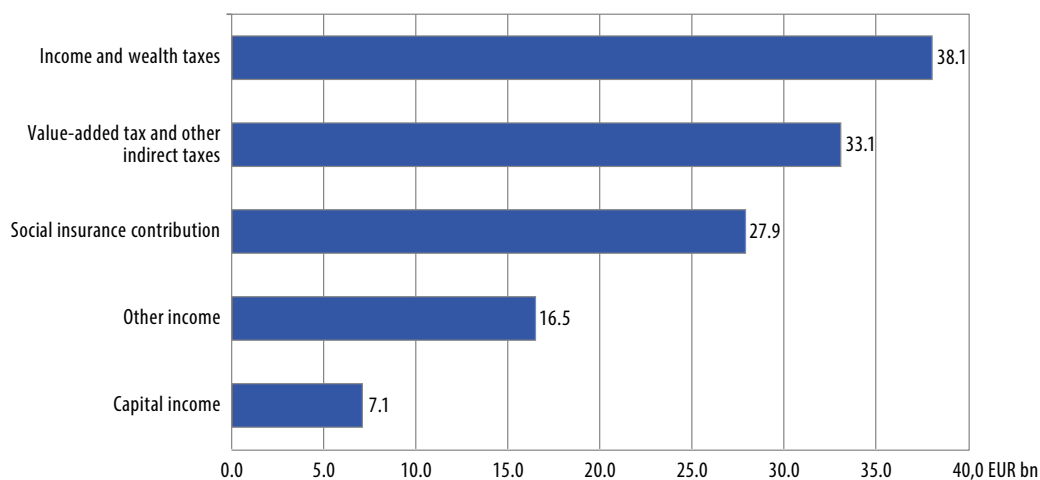


Diagram 2. General government revenue in 2018, EUR bn

Source: Statistics Finland

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

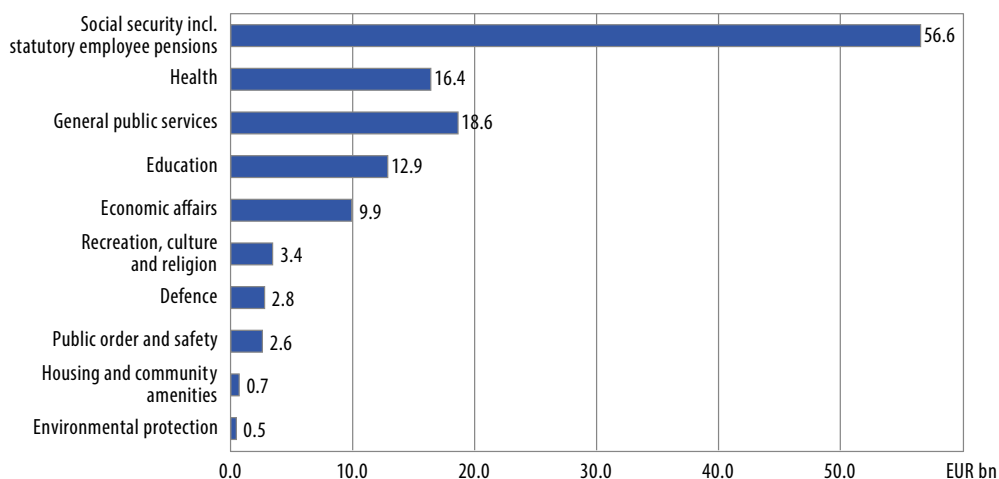


Diagram 3. General government expenditure by function (COFOG) in 2018, EUR bn

Source: Statistics Finland, National Accounts

Table 3 illustrates the average order of magnitude of costs incurred from education and culture as well as social welfare and healthcare services. For example, the table reveals

that the costs per student of upper secondary vocational education and training were the highest compared with other forms of education in 2018.

Table 3. Average expenses of selected public services in 2018

	EUR	
EDUCATION AND CULTURE		
Basic education	9,218	/pupil/year
Upper secondary education	7,734	/student/year
Initial vocational education	10,513	/student/year
University of applied sciences education	8,163	/student/year
Budget funding for university education	7,980	/student/year
Public libraries	3.8	/loan
SOCIAL SERVICES		
Children's day care ¹⁾	89.4	/day
Old people's homes ²⁾	163.9	/day
HEALTH CARE SERVICES		
Basic health care		
- Visit to health centre ³⁾	80.4	/visit
- Ward treatment	317.0	/day
- Dental care	117.7	/visit
Special medical treatment		
- Somatic specialised medical treatment ⁴⁾	1,097.0	/day

1) Includes part-time and full-time day care financed by municipalities. The number of days of care has been weighted in terms of part-time and full-time day care, with a weighting factor of 0.6 used for days of part-time day care and a weighting factor of 1 for days of full-time day care.

2) Based on the costs of the six largest municipalities.

3) Includes all visits, incl. e.g. child welfare clinic and physiotherapy. The average cost of a visit to a doctor in basic health care is EUR 90/visit.

4) Includes inpatient care and day surgery

Sources: National Board of Education, National Institute for Health and Welfare and Finnish Public Libraries Statistics

3 The Government's economic policy approach

Prime Minister Marin's Government is implementing an active and responsible fiscal policy that is scaled to the economic outlook. In 2020, decisions have been made on numerous measures that aim to deal with the coronavirus situation, including both curbing the spread of the virus and supporting citizens and businesses. Automatic budget stabilisers also support demand during the recession.

Some of the decisions made in the 2020 supplementary budget will also be reflected on 2021, for example in the form of multiannual transport infrastructure projects and disbursement of business subsidies. They will increase central government spending by some EUR 1 billion in 2021. Supporting local government finances will continue in 2021, and the Government will also propose appropriations for the immediate costs of the coronavirus outbreak, such as testing and treatment.

The extent of the fiscal stance in 2021 will also be influenced by the implementation of the EU's recovery instrument and the related national recovery and resilience plan drawn up for Finland. The Government has outlined a sustainable growth agenda for Finland, which involves initially allocating the funding of the recovery instrument to the following priorities:

- putting Finland back on the path towards sustainable growth through education, research and innovation activities
- a green transition supports structural change in the economy
- ensuring Finland's international competitiveness
- strengthening sustainable infrastructure and digitalisation
- functioning of the labour market, services for unemployed people and developing working life
- enhancing the availability of social welfare and healthcare services and increasing cost-effectiveness.

The budget proposal for 2021 does not yet contain estimates of revenues and expenditure caused by the recovery instrument. During the autumn, the Government intends to submit a report to the Parliament on the national utilisation of funding channelled through the EU's recovery instrument. The revenue estimates and corresponding appropriations related to the recovery instrument will be taken into account in the supplementary budget of 2021.

Fiscal policy objectives and rules

The aim of the Government is to stabilise general government debt-to-GDP by the end of the decade.

The ultimate goal is to strengthen the crisis resilience and sustainability of general government finances. Safeguarding the long-term sustainability of government finances also requires continuing the measures beyond the current parliamentary term.

On 20 March 2020, the European Commission published a communication whose purpose was to activate the general escape clause of the Stability and Growth Pact as a result of the severe economic recession caused by the coronavirus situation across the EU and the need to respond to this with an adequately proportioned public investment. In their joint opinion published on 23 March 2020, the Member States gave their support to the activation of the clause. The general escape clause allows the Member States to temporarily derogate from the consolidation path towards the medium-term budgetary objective, provided that this does not jeopardise the medium-term sustainability of public finances.

As a result of the activation of an exemption clause applying to the entire EU region, Finland is also subject to exceptional conditions under the Stability and Growth Pact. Due to the current exceptional circumstances, the Government did not set multiannual budgetary targets for general government finances or budget position targets for each general government subsector in the General Government Fiscal Plan published on 16 April 2020. Setting multiannual targets for general government is more worthwhile once there is a clearer understanding of the prevailing conditions.

Central government spending limits

The central government spending limits procedure is the most essential anchor of the Government's fiscal policy as other medium-term fiscal policy rules remain in the background as a result of the coronavirus situation.

In March 2020, the Government, together with the President of the Republic, announced that Finland was in emergency conditions due to the coronavirus situation. The Emergency Powers Act was also invoked. Under these circumstances, the central government

spending limits have not posed restrictions to 2020, which has involved temporary and targeted measures such as combating the impacts of coronavirus on health and the economy.

The Government is committed to the central government spending limits procedure and the spending limits for the parliamentary term set out in the General Government Fiscal Plan adopted on 7 October 2019. While spending limits will be complied with again as of 2021, there continue to be certain exceptions owing to the coronavirus situation. Measures included in the Government Programme and other measures will be implemented insofar as this is possible within the framework of the spending limits.

The coronavirus situation has also continued to be difficult after the expiry of the emergency conditions and the adoption of the Emergency Powers Act. As a result, all direct costs related to coronavirus, including testing and increasing testing capacity, tracing, quarantines, patient care, travel health safety and vaccine, are fully covered as expenditure outside the spending limits in the 2021 budget and, if necessary, supplementary budgets. In addition, as a result of the coronavirus situation, expenditure related to increasing the budget authority of business funding was exceptionally classified outside the spending limits already in the spring 2020 General Government Fiscal Plan. An additional spending limits reserve of EUR 500 million will also be introduced in 2021 to be used for one-off expenditure needs arising from the coronavirus situation that are obligatory for fiscal policy purposes. If the expenditure referred to above falls below the spending limit projections, the difference is not used to increase other expenditure.

In April 2020, the Government decided to start preparing the activation of a state of emergency mechanism included in the rule on spending limits. In May, the Cabinet Committee on Economic Policy expressed its endorsement of invoking the emergency mechanism for the Government, as a result of which the level of the spending limits in 2021 will be EUR 500 million higher than originally planned. The state of emergency mechanism is intended to be used for one-off expenditure under the spending limits rule.

Fiscal policy measures and general government sustainability roadmap

Measures to maintain stable and balanced general government finances must be taken alongside the post-crisis recovery and reconstruction efforts. This is necessary in view of the Government's promise of intergenerational justice.

The crisis caused by coronavirus created a need to specify the objectives of the government programme for the long-term stabilisation of public finances. In the first phase of the sustainability roadmap in June 2020, the Government outlined the objective of stabilising the general government debt to GDR ratio by the end of the decade.

In accordance with the sustainability roadmap, key measures for strengthening general government finances are:

- increasing employment and reducing unemployment
- reinforcing the framework for economic growth
- strengthening the productivity of public administration and measures to increase cost-effectiveness and
- health and social services reform.

During the government term, the Government will carry out employment measures that strengthen the economy with an aim to achieve the employment impacts of 80,000 additional employed persons. The measures decided in the 2020 budget session aim at increasing the number of employed people by between 31,000 and 36,000 together with the measures already taken by the Government to increase employment and a negotiating mandate given to labour market organisations.

Employment will be increased and unemployment will be reduced through measures such as raising the age limit for the right to additional days of unemployment benefit, reforming the provisions on pay subsidies, extending compulsory education, lowering early childhood education and care fees, and moving towards the Nordic model of employment services. The Government also gives an assignment to the social partners to submit a joint balanced proposal for measures to promote the employment rate of those aged over 55, and to improve their labour market position and coping at work. The social partners are required to provide a proposal by the end of November 2020. If the assignment fails at meeting the set objectives, the Government will outline the necessary measures with details in December 2020. The Government will continue to prepare employment measures to ensure that decisions can be made on the following set of measures supporting employment in the Government's mid-term review in spring 2021.

The prerequisites for economic growth are supported through measures such as by strengthening the conditions for research and development as part of Finland's sustainable growth agenda. A decision on the policies will be made in a report submitted to the Parliament in the autumn.

The productivity and cost-effectiveness of public administration will be strengthened through measures concerning public procurement, facility management and digitalisation, and by increasing the cost-effectiveness and efficiency of health and social services.

The Government will submit legislative proposals on the health and social services reform to the Parliament in December 2020. The Government's objective is to implement the reform so that the responsibility for organising services will be transferred to counties on 1 January

2023. The impact of the reform on the sustainability of general government finances depends on the extent to which central government is able to guide the counties responsible for organising health and social services to cost-effective activities. However, it remains unclear whether savings can be generated in the 2020s, as the reform involves significant transition costs. The growth of expenditure can probably only be curbed as of 2030s.

The policies outlined in the autumn 2020 government budget session will be complemented in the 2021 government spending limits discussion when the sustainability roadmap is finalised. The national allocation of the funding from the EU's Recovery and Resilience Facility (RRF) is also linked to the implementation of the sustainability roadmap.

If the structural reforms under preparation and those aiming to accelerate growth fail to sufficiently strengthen general government finances as intended, the Government is committed to taking new measures or also resorting to measures that have a quick impact on public revenue and expenditure.

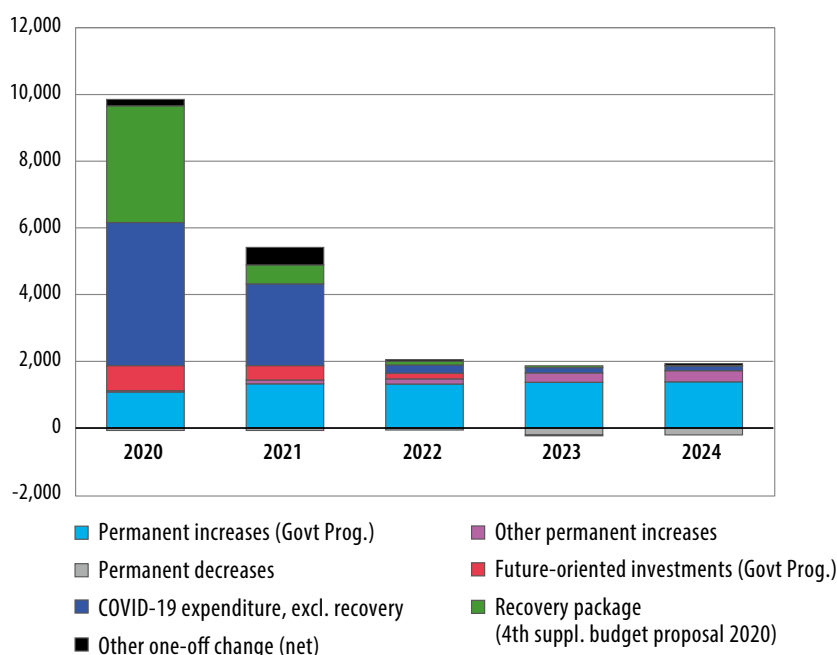


Diagram 4. Government's discretionary increases and decreases in appropriations since the spring 2019 technical General Government Fiscal Plan, EUR million

In 2021, the Government's discretionary spending increases totalled at approximately EUR 5.3 billion compared to the technical General Government Fiscal Plan of spring 2019, as illustrated by Diagram 4. The implementation of the government programme will continue.

The permanent spending increases in accordance with the government programme amount to some EUR 1.3 billion at 2021 levels (EUR 1.1 billion in 2020) compared to the spring 2019 technical General Government Fiscal Plan. Investments are allocated to areas such as social security and health and social services, early childhood education and care, education and research, and environmental protection and climate policy measures.

Any permanent additional expenditure will be primarily covered by discretionary permanent additional revenue as well as reallocation of resources. The solutions concerning taxation also aim at promoting the set climate targets. The Government will consolidate the tax base and increase indirect taxes.

During the parliamentary term, a one-off future-oriented investment programme will be implemented, which will no longer increase general government expenditure in 2023. Around EUR 440 million has been allocated for 2021 related to this programme. Nearly EUR 80 million in additional investments from the national housing fund will also be allocated in 2021. In the following phase of the future-oriented investment programme, funding from the EU's Recovery and Resilience Facility and future-oriented investments will be combined into a whole with structural and stabilisation policy influence. To the extent that funding is allocated to the Government's original future-oriented investments, the aim is to include the proposals for 2021 appropriations in the supplementary budget proposal as prepared by the Cabinet Committee on Economic Policy. The appropriations are made to include proposals concerning issues such as resources for vocational education and training, early childhood education and care, continuous learning, the development of working life and wellbeing at work, nature conservation and the development of sparsely populated rural areas.

Allocating the reserve initially intended for future-oriented investments to other purposes than those listed in the government programme is also considered reasonable from a structural and stabilisation policy perspective. To the extent that this is the case, expenditure will not be financed by property income. Due to the current market situation, the previously decided sales of shares related to the financing of future investments have also been postponed and are now expected to take place in the period 2021—2022.

4 Central government budget proposal 2021

Central government revenue and expenditure are examined in the general strategy and outlook of the budget proposal in Chapters 4 and 5 as well as in the detailed rationale ([budjetti.vm.fi](#)). The revenue estimates are presented by department and the appropriation estimates by administrative branch.

4.1 Revenue, expenditure, deficit and debt

Revenue

Central government on-budget revenue for 2021, excluding net borrowing, is estimated at around EUR 53.4 billion. Taxes and tax-like payments account for approximately EUR 45.2 billion (85%). Central government tax revenue is expected to increase by about 8%, or EUR 3.2 billion, in 2021 compared to the revenue budgeted for 2020 (incl. supplementary budgets). Compared to the actual 2020 budget the central government tax revenue is expected to decrease by 4%, or 1.8 EUR billion.

Diagram 5 shows the development of central government tax revenue for key tax types in the period 2006—2021. Tax revenue growth has been moderate in recent years and will decline significantly in 2020 due to the economic impact of the coronavirus epidemic. Tax revenue will take an upward swing as economic activities recover in 2021. Part of the tax revenue for 2020 will be paid in 2021 as a result of temporarily easing the terms of tax payment arrangements. The impact of the payment arrangements will increase the central government's tax revenue for 2021 by an estimated EUR 0.5 billion. The vast majority of this impact results from the payment arrangements related to the value-added tax. Due to a change in excise taxation procedures, the payment of excise duties will be delayed as of the beginning of 2021, and this is estimated to result in postponing around EUR 0.6 billion of tax revenue to the following year.

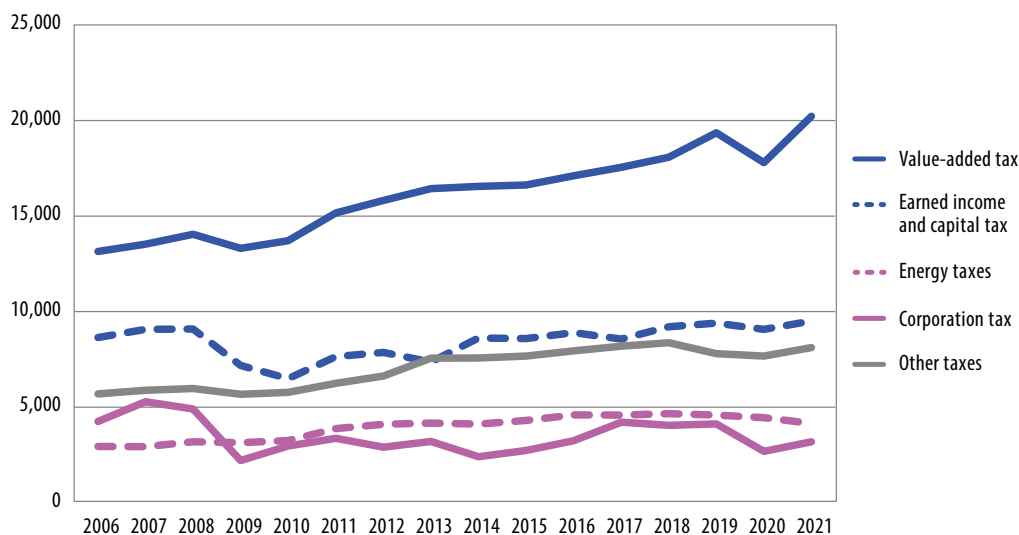


Diagram 5. State tax revenue by type 2006–2021, EUR million

Expenditure

The appropriations of the budget proposal amount to EUR 64.2 billion, which is approximately EUR 6.5 billion more than in the actual 2020 budget. The total appropriations amount to EUR 3.1 billion less than what was budgeted for 2020, including supplementary budgets. The 2020 supplementary budgets have allocated significant additional appropriations to managing the coronavirus situation and stimulating the economy. Taking into account price rises and structural changes in the budget proposal, the appropriations for administrative branches will increase by around 10% from the actual 2020 budget. The expenditure will also be higher due to temporary increases in expenditure related to the coronavirus outbreak, including an increase in expenditure related to unemployment, statutory and contractual index increases, the central government wage agreement, and additional, previously decided investments, such as the estimated expenditure impacts of the purchase of HX fighter aircraft.

The allocation of appropriations, i.e. central government expenditure, to different purposes depends on political decisions, economic structures and economic cycles. The total on-budget central government expenditure will grow by 11.3% from the amount given in the actual 2020 budget. An examination of the expenditure grouped according to the Classifications of the Functions of Government (COFOG) reveals that the largest single factor explaining the increase is preparedness for the social welfare and healthcare costs resulting from the coronavirus outbreak. Healthcare expenditure will increase by 29.5%, which explains nearly a third of the increase in total expenditure. Another important factor

increasing the expenditure is an investment in military defence. The appropriations required for the renewal of fighter aircraft explain 2.6% of the increase in total expenditure.

As a consequence of the coronavirus epidemic, the general economic situation is clearly poorer than that anticipated in the actual 2020 budget. As a result, expenditure related to social security and the promotion of business will grow more rapidly than in a usual situation. The appropriations related to social security will increase by 4.7% as unemployment security expenditure increases. On the other hand, expenditure related to the promotion of business and industries will increase by 10.2%, which will increase total expenditure by 1.4%. The subsidies available for business and industries are increased by, for instance, investments in research, development and innovation activities, the capitalisation of Finnish Minerals Group and preparation for Finnvera Plc's loss compensation and interest subsidies.

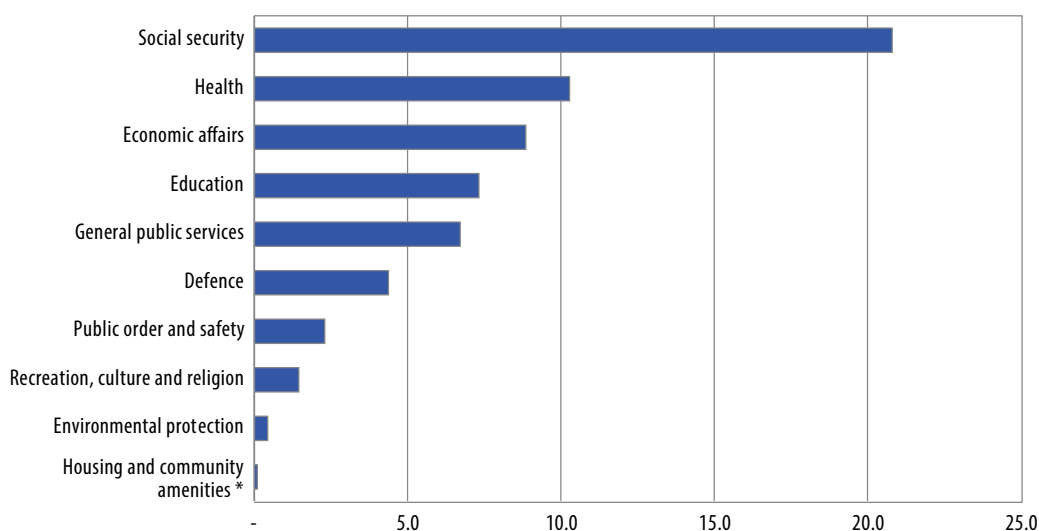


Diagram 6. Budget appropriations in 2021 by function (COFOG), EUR bn

* 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.

Part of the revenue in the central government budget is received from the European Union, while Finland also pays contributions to the EU. At central government level, Finland is projected to contribute approximately EUR 2.5 billion to the EU budget and the European Development Fund in 2021. Finland's contributions will be EUR 338 million higher than the figure budgeted for 2020. Finland is expected to receive approximately EUR 1.1 billion in revenue from the EU budget, which is EUR 51 million less than the projected figure for 2020. The relationship between EU revenue and expenditure in central government finances is illustrated in Table 4.

Table 4. Flow of payments between Finland and the EU 2019–2021, EUR million

CENTRAL GOVERNMENT EXPENDITURE	Final accounts 2019	Budget 2020	Budget proposal 2021
On-budget finances			
VAT payment	312	316	319
GNI payment	1,666	1,624	2,098
Finland's share of the UK budgetary rebate	130	147	
EU PAYMENTS TOTAL	2,109	2,087	2,417
European Development Fund	71	68	76
TOTAL	2,180	2,155	2,493
CENTRAL GOVERNMENT REVENUE	Final accounts 2019	Budget 2020	Budget proposal 2021
On-budget finances			
Agricultural support	528	537	537
Rural development support	349	370	310
Subsidies from structural funds and cohesion funds	163	190	200
Customs duties and other levies	38	38	42
Other revenue	37	43	37
Off-budget finances			
Intervention Fund of Agriculture	0	0	0
Fund for Agricultural Development	0	0	0
TOTAL	1,115	1,177	1,126
Customs duties, agricultural payments and sugar payments collected on behalf of the EU	188	189	210

The year 2021 is the first year of the new EU Multiannual Financial Framework period. In July 2020, the European Council reached an agreement on the 2021–2027 financial framework, a new recovery instrument for the recovery of the economies of the EU Member States following the coronavirus epidemic, and a EU-wide financial system, i.e. the Union's system of own resources. As the negotiations on the new financial framework will continue in autumn 2020 with the European Parliament, the figures for the payment flows between Finland and the EU presented in this report and in Table 4 will likely be further specified later.

Deficit

The central government budget proposal for 2021 shows a deficit of approximately EUR 10.8 billion, which will be covered by increased borrowing. In national accounting terms, the central government deficit for 2021 is expected to be approximately 4.4% in ratio to GDP. Central government on-budget activities have shown a deficit since 2009. In 2020 and 2021, the on-budget deficit will be significantly increased by costs related to the

coronavirus outbreak, the deterioration of tax revenue and measures aimed at economic recovery. The situation is illustrated in Diagram 7.

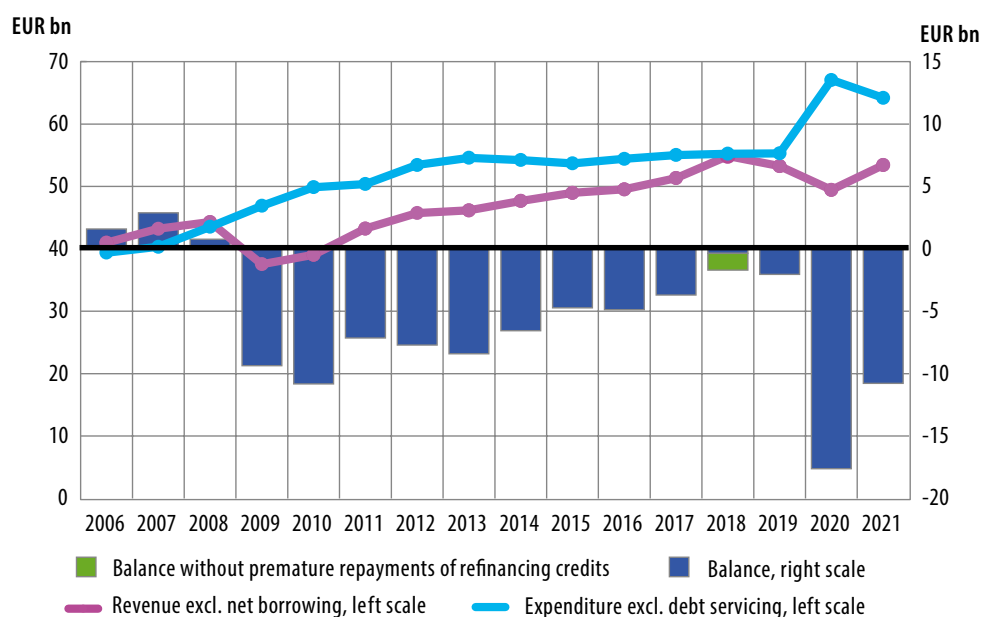


Diagram 7. Central government budget revenue, expenditure, and balance 2006–2021, EUR billion

Debt

At the end of 2021, central government debt, including the debt of off-budget entities, is expected to be approximately EUR 135 billion, which is approximately 56% in ratio to GDP. Diagram 8 shows that the central government debt-to-GDP ratio has taken a sharp upward turn since 2020.

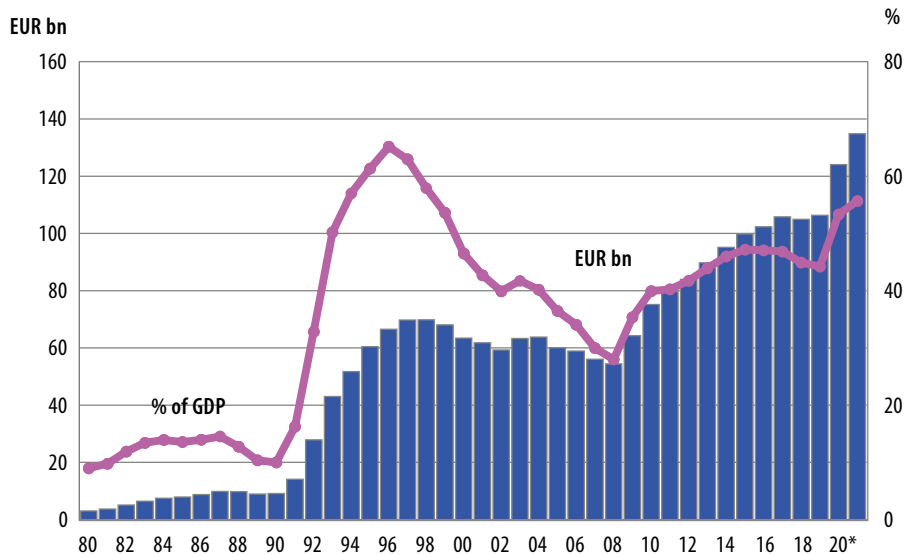


Diagram 8. Central Government Debt 1980–2021

4.2 Excerpts from tax and appropriation decisions in budget proposal 2021

Tax criteria changes

In accordance with the government programme, earned income tax criteria will be subject to an index adjustment at all income levels. The tax base will be consolidated in 2021 by continuing to phase out tax deductibility of mortgage interest payments. The impact of the government proposal on the taxation of the issue of shares to employees in unlisted limited liability companies is expected to reduce the earned and capital income tax returns from 2021 onwards. The tax-free share of employer-subsidised commuter tickets will be increased and related taxation will be simplified. In the period 2021–2023, the taxation value of the unrestricted car benefit and operating benefit for fully electric cars will be reduced on a fixed-term basis. The electric car charging benefit will be exempted from taxation for a fixed period between 2021 and 2023. The company bicycle benefit will be given a tax-exempt status. The share of public transport in a mobility service package offered as an employee benefit is considered to have the same status as a tax-free employer-subsidised commuter ticket.

In 2021, net taxes on machinery and heating fuels will be raised by EUR 105 million and electricity tax category II will be reduced to the EU minimum. Both tobacco and alcohol taxes will be raised by EUR 50 million. Halving the fairway due intended to support the

export industry will continue. Cutting the lottery tax to improve Veikkaus' conditions for generating revenue will reduce the annual tax revenue by EUR 87 million.

The lower limit for VAT liability will be raised to EUR 15,000 from the beginning of 2021, which is estimated to reduce the annual tax revenue by some EUR 20 million. However, the impact is expected to be mainly only visible in 2022 tax revenue due to tax payment schedules. In addition, the tax exemption for low-value products imported from outside the EU will be abolished in 2021.

As part of a package related to supporting local government finances and to compensate for the lowering of early childhood education and care fees, the municipalities' share of corporate tax revenue will be increased by 12 percentage points for the tax year 2021 and by 2 percentage points from the tax year 2022 onwards. This change will reduce the corporate tax revenue obtained by central government by EUR 612 million in 2021. The changes in the tax criteria will reduce central government's annual tax revenue by approximately EUR 1 billion. The most significant individual factor is the change to the corporate tax apportionment.

In accordance with the government programme, the municipalities will be compensated for the tax revenue impact of changes made by the Government to tax criteria on a net basis.

General public services (incl. foreign service)

An increase of EUR 5.1 million from the actual budget for 2020 is proposed for the operating expenditure of the Prime Minister's Office. Appropriation under the item will be allocated to, e.g. the Finns in Russia 1917–1953 project.

EUR 3.9 million is proposed to the operating expenditure of the Office of the Chancellor of Justice, EUR 0.4 million more than in the 2020 budget.

A total of EUR 1.2 billion is proposed for international development cooperation. In 2021, the level of development cooperation appropriations is expected to be approximately 0.49% in ratio to GNP. EUR 10 million is proposed for raising Finnfund's capital and EUR 130 million for fiscal investments in development cooperation.

EUR 3.0 million is proposed for the expenditure on scientific and cultural institute properties located abroad. The renovation of Villa Lante, implemented in the period 2020–2022, is the most important project.

An appropriation of EUR 3.2 million will be allocated the activities of a new permit authority managing data use in social welfare and healthcare, which was launched in 2020.

EUR 6.5 million is proposed for the Finnish Customs to raise its ICT capacity and human resources in response to an amendment of the VAT directive.

Defence

Appropriations of around EUR 4.9 billion are proposed to the administrative branch of the Ministry of Defence, which is EUR 1.7 billion more than in the actual 2020 budget. The increase arises from, e.g. starting financing the purchase of the multirole fighters.

Around EUR 2 billion is proposed for the operational expenditure of the Finnish Defence Forces, with an increase of EUR 23 million compared to the actual 2020 budget. The increase arises from, e.g. an increase in the number of personnel, tasks and refresher training exercises, as well as the costs resulting from the adoption of the Act on Military Intelligence and other expenses known as the adjustment to technical costs.

It is proposed that the procurement of multirole fighters to replace the Finnish Hornet fighter jet fleet capability should be budgeted as a whole for 2021 so that the item includes a new procurement authority of EUR 9.4 billion and a deferrable appropriation of EUR 579 million. This expenditure will be distributed over the period 2021—2031.

The procurement authorities newly and previously granted to the Defence Forces in accordance with the 2021 budget proposal will result in expenditure amounting to a total of EUR 1.6 billion in 2021 and a total of EUR 10.3 billion in the years succeeding the budget year (incl. HX and Squadron 2020).

Public order and safety

To ensure the effective implementation of the government programme as well as the quality and continuity of the Government's legislative drafting, an increase of EUR 1.0 million is proposed to the Ministry of Justice.

Additional funding amounting to EUR 2.7 million is proposed to the courts to facilitate smooth court proceedings. An increase of EUR 1.7 million is proposed for dealing with the backlog of water and environmental issues.

An increase of EUR 2.5 million is proposed for the National Prosecution Authority to ensure the implementation of criminal liability. An increase of EUR 5 million is proposed for the implementation of a data bank project of the National Prosecution Authority and the general courts. The aim is to streamline judicial proceedings and the legal process, for example by means of digitalisation.

An increase of EUR 8.8 million is proposed for the courts, the National Prosecution Authority and the Criminal Sanctions Agency to cover the costs resulting from reforming the conversion of unpaid fines into imprisonment.

Additional funding of EUR 5.9 million compared to the 2020 budget is proposed for administrative courts and legal aid for asylum seekers' legal protection.

There is a growing need for public guardianship due to the ageing of the population. Due to an increase in the number of clients, an increase of EUR 1.9 million is proposed for guardianship offices.

An increase of EUR 3.3 million is proposed in the operating appropriations of the Criminal Sanctions Agency to cover expenditure arising from legislative amendments. An increase of EUR 1.85 million is proposed for the rental costs of the new women's prison in Hämeenlinna and EUR 3.2 million for the renewal of security technology in prisons.

EUR 848 million is proposed to the police force. The proposed increases include EUR 10 million to safeguard police capacity, EUR 4.1 million to strengthen crime prevention and around EUR 0.5 million to strengthen the investigation of the grey economy and financial crimes.

A total of EUR 276.6 million is proposed to the Finnish Border Guard. The budget proposal pays attention to the objective recorded in the Government Programme for safeguarding the performance of border security and the number of border guards by increasing the appropriations for the operating expenditure of the Finnish Border Guard by EUR 1 million in 2021. The Border Guard is proposed to be provided an additional appropriation of EUR 10 million for the purpose of securing operational performance and an appropriation of EUR 2.5 million for the improvement of property security.

The Border Guard assigns personnel and equipment to the European Border and Coast Guard Agency. Due to EU obligations, the following additional funding is proposed to the Border Guard: around EUR 2.5 million for purposes such as the ETIAS passenger name records and permit system, EUR 0.3 million to the amendments to SIS regulations, and around EUR 3.5 million for expenditure related to European Border and Coast Guard troops and activities.

A total of EUR 79 million is proposed for the operating costs of the rescue services and the Emergency Response Centre Agency. The proposal takes into account the objective in the government programme regarding ensuring the capacity and resources of rescue services and emergency response centre operations.

It is proposed that the quota for refugees be increased by 200 persons to 1,050 persons. An increase of EUR 2.1 million is proposed for 2021 for the administrative branches of the Ministry of the Interior and the Ministry of Economic Affairs and Employment.

For the Finnish Immigration Service, an increase of EUR 8 million is proposed for dealing with the backlog of applications for residence permits based on work or studies and EUR 4 million for the maintenance and development of the UMA information system.

Economic affairs

A total of EUR 599 million is proposed as energy policy appropriations, which is an increase of EUR 477 million compared with the amount in the actual 2020 budget. EUR 155 million of the increase is due to an additional appropriation proposed for compensating for Finnvera Plc's losses and interest subsidy. Due to the coronavirus situation, Finnvera's domestic funding authority was expanded, and the percentage of compensation for credit and guarantee losses was increased from 50% to 80%, which increases central government expenditure. An appropriation of EUR 300 million is proposed for the capitalisation of the Finnish Minerals Group to be used for the disbursement of the budget authority of the fourth supplementary budget for 2020.

A budget authority of EUR 336 million is proposed for Business Finland to support research, development and innovation activities. EUR 8.35 million of this sum will be allocated to the continuation of a production incentive in the audio-visual industry.

A EUR 12 million increase is proposed for the discretionary government transfer of the Technical Research Centre of Finland in an aim to strengthen the centre's participation in the new EU Horizon Europe framework programme.

An increase of EUR 3.4 million is proposed for the operating expenditure of the ELY Centres related to new tasks. This increase is mainly due to tasks related to promoting the integration of immigrants and the immigration of labour force, the employment of persons after a long-term family leave, the disbursement of a SME recruitment subsidy, strengthening the resourcing of the area of responsibility of transport and infrastructure, and a new advisory task established in response to the implementation of the Renewable Energy Directive (REDII).

An appropriation of EUR 297 million is proposed for public employment and business services, totalling at EUR 24 million more than in the actual budget for 2020. EUR 2 million is proposed to accelerate the employment of persons returning from on long-term family leave, which will be expanded to include the target group of immigrant parents. The piloted services would include career coaching, including language and interpretation

services, and childcare services. In addition, EUR 7.65 million is proposed for a pilot project involving a subsidy encouraging SMEs in recruitment; EUR 3 is proposed for further increasing the pay subsidy.

For the operating expenditure of the TE Offices, an increase of EUR 1.1 million is proposed for local government pilot projects to boost employment, an increase of EUR 2.5 million for strengthening the Ohjaamo service points, and an increase of EUR 0.2 million for introducing the Kohti oppisopimusta ("Towards apprenticeship") model. The plan is to launch the local government pilot projects to boost employment on 1 January 2021.

EUR 160 million is proposed as the budget authority for energy subsidies. It is proposed that supporting the investments aiming at phasing out coal be brought forward from 2022 by already raising the authorisation to grant energy subsidies by EUR 30 million in the 2021 budget. Bringing the subsidy decisions forward by one year enables hastening the investments in the energy sector, which contributes to stimulating the economy.

A total of EUR 121 million is proposed for the compensation subsidy expenditure related to the indirect costs of emissions trading, which is EUR 43 million more than in the actual 2020 budget. The increase is due to a change in the price of the emission allowance. The current emissions trading compensation system will be discontinued under the valid legislation, and the final payments resulting from the system will be allocated to 2021. The Government has made a decision on creating a new electrification subsidy for energy-intensive companies, which will encourage increasingly efficient carbon neutral production and the electrification of energy-intensive companies while taking cost-competitiveness into account.

A new increase of EUR 0.5 million is proposed for the operating costs of the Energy Authority due to, for example, additional tasks required by new legislation and investments in information systems.

EUR 9 million is proposed for the promotion of integration and the immigration of labour force, totalling at EUR 3.5 million less than in the actual 2020 budget. The decrease in the appropriation is due to a reduction in funding allocated to the activities of multi-professional competence centres in municipalities, to guidance and counselling services for immigrants, and internal transfers of appropriations.

EUR 171 million is proposed for specified government transfers on integration, totalling at EUR 14 million less than in 2020. The transfers are reduced by EUR 21 million due to a decrease in the number of asylum seekers who have been granted a residence permit and a reduction in the care costs of unaccompanied minors. On the other hand, an increase totalling at EUR 7 million is proposed. This increase is proposed due to factors such as raising

the age limit for unaccompanied minors from 21 to 25 years, accepting refugees with a vulnerable status to Finland, and raising the refugee quota by 200 to 1,050 persons.

In agriculture and forestry, additional investments will be allocated to research and development activities and, for example, supporting agricultural advisory services. In addition, funding of EUR 2 million is proposed for the Kyläkaupat monipalvelukeskuksina ("Village shops as multi-service centres") pilot projects.

EUR 2 billion will be allocated to transport networks, of which EUR 1.36 billion will go towards basic transport infrastructure maintenance. EUR 654 million will be allocated to the development of the transport network. In addition to actual development projects, this sum will cover life cycle projects, purchase of land and water areas, infrastructure subsidies for transport routes and private road subsidies as well as grants for promoting walking and cycling. Newly launched projects will include developing the Äänekoski–Viitasaari road section of main road 4, 1st phase of upgrading the Tampere–Jyväskylä railway track, improving the capacity of the Oulu–Kemi railway section, deepening the Kemi Ajos fairway, and extending the locks of the Saimaan Canal. The budget authority granted to the projects total at EUR 205.5 million, and the impact of the appropriations amounts to EUR 30 million in 2021.

A total of EUR 783 million is proposed for transport and communications services, of which EUR 89 million is proposed for improving the competitiveness of vessels used in maritime transport, EUR 18.7 million for subsidies to transport and communications services and EUR 19.1 million for the purchase and development of island and ferry traffic. The broadband programme will be continued with additional funding of EUR 5 million. EUR 108.2 million will be allocated to the purchase and development of public passenger transport, which will include a general increase of EUR 20 million for climate-based measures in accordance with the government programme

Environmental protection

A total of EUR 15 million is proposed for enhancing water conservation.

As part of the increases in nature conservation funding, the implementation of the Helmi habitats programme and the Forest Biodiversity Programme for Southern Finland (METSO) will continue. EUR 46 million will be spent on the Helmi programme, including the protection of marshlands. An action programme for the conservation of biodiversity will be launched. An appropriation of around EUR 60 million is proposed as the budget for Metsähallitus' public administration tasks, and funding is particularly strengthened with regard to nature conservation tasks.

An appropriation of EUR 5 million is proposed for accelerating the climate work in municipalities and regions.

An increase of EUR 1 million is proposed for carrying out surveys and risk assessments at old mining sites.

EUR 0.75 million is reserved for the activities of the Finnish Climate Change Panel under the Climate Change Act.

It is proposed that an appropriation of EUR 4 million will be transferred to the Oil Pollution Compensation Fund, which is not included in the Budget, to cover the costs of compensating for oil spills and the costs incurred by the rescue services due to preparedness for oil spill response.

Housing and communities

In 2020, an agreement was reached in negotiations on the framework agreements on land use, housing and transport (MAL) between central government and four regions (Helsinki, Turku, Tampere and Oulu regions). The MAL agreements will be promoted by means of municipal technology grants, for which an appropriation of EUR 25 million is proposed, and start-up grants for state-subsidised housing production, for which a total of EUR 40 million is proposed. Of this, an estimated EUR 10 million would be allocated to supporting wooden block of flats of the ARA Housing Finance and Development Centre of Finland. ARA's wooden blocks of flats would also be supported in areas outside the MAL regions. EUR 1.8 billion is proposed in interest subsidy authorisations intended for state-subsidised housing production.

A grant appropriation of EUR 10 million is proposed for encouraging households to abandon oil heating. In addition, energy-efficient renovations would be supported by energy subsidies, for which EUR 40 million is proposed.

An appropriation of EUR 7.3 million is proposed for the creation of a digital register and information platform for the built environment. This appropriation aims to support the development of a digital built operating environment in municipalities and connecting this to national structures.

Healthcare

Significant appropriations are proposed for healthcare expenditure related to the coronavirus situation. In 2021, EUR 1.4 billion is proposed for testing and tracing required by the hybrid strategy and EUR 30 million for testing technology. EUR 30 million is proposed for

the costs of health security at border crossing points in 2021. In addition, EUR 200 million is proposed to compensate municipalities, joint municipal authorities and the Province of Åland Islands for other direct COVID-19-related costs.

Student healthcare provided by the Finnish Student Health Service will be expanded from higher education institutions to also include universities of applied sciences. The central government will allocate EUR 65.8 million in funding for these activities.

Central government funding for university-level research in healthcare and social work amounts to EUR 25 million. The central government reimbursement for social welfare and healthcare units for the provision of specialisation training for social welfare and healthcare personnel is EUR 96 million.

A total of EUR 122.9 million has been reserved for the development of the social welfare and healthcare service structure, or EUR 25 million more than in the actual 2020 budget.

EUR 5 million is proposed to support the health sector growth strategy.

A discretionary government transfer of EUR 27.8 million will be granted to FinnHEMS Oy for the production of air ambulance and medical helicopter operations. The provision of the service as a central government activity is under preparation.

A EUR 5 million appropriation is proposed for the implementation of a medicines roadmap.

Recreation and culture

EUR 576 million is proposed for the appropriations for art and culture, which is EUR 91 million more than in the 2020 budget. The increase is due to issues such as a change in the budgeting of basic education in the arts. In 2021, a total of EUR 60.5 million in budgetary funds is allocated for the promotion of the arts to compensate for the fall in revenue from gambling activities.

An additional appropriation is proposed for the European Capital of Culture 2026 project.

A budget authority of EUR 122 million is proposed for the rental agreement of the additional building of the National Museum. The related expenditure will occur in the period 2025–2039.

A total of EUR 156 million is proposed for the appropriations for sports services. The promotion of physical activity and top athletics will continue in accordance with the government programme and the implementation of the report on sport policy. In 2021, a total of

EUR 39.3 million in budgetary funds is allocated to promoting sports education to compensate for the fall in revenue from gambling activities.

Education

The age of compulsory education will be raised to 18 years, and free upper secondary education will be implemented in this context. EUR 22 million will be reserved for this purpose in 2021.

In accordance with the government programme, pupil and student welfare services will be strengthened by EUR 10 million in basic education and upper secondary education.

Preparations will be made for a change in the number of caregivers by increasing the number of practical nursing students, for which purpose EUR 27 million is proposed.

EUR 3.4 billion is proposed for higher education and research, with an increase of EUR 78 million compared to the actual 2020 budget.

EUR 660 million is proposed for student financial aid, EUR 42 million more than in the 2020 budget. The development of the student financial aid system will continue to ensure that the system promotes goal-oriented and full-time studies and shorter study times. The need for the appropriation reserved for student loan credits and the state guarantee for student loans is estimated to increase by a total of EUR 15 million.

Due to an increase in the meal allowance that will enter into force at the beginning of 2021, an increase of EUR 4.2 million is proposed for the meal subsidy for higher education students in 2021.

Social security (incl. earnings-related pensions)

Appropriations of around EUR 4.5 billion are proposed to the equalisation of family and housing costs, basic social assistance and certain services, which is EUR 270 million more than in the actual 2020 budget. The increase is mainly due to a rise in unemployment caused by the coronavirus outbreak, which increases the benefit expenditure related to the general housing allowance and basic social assistance, and the operating costs of the Social Insurance Institution of Finland.

A total of EUR 468.5 million is proposed for the operating expenses of the Social Insurance Institution of Finland, or EUR 28.2 million more compared to the actual 2020 budget.

Appropriations of around EUR 2.9 billion are proposed to unemployment security, or EUR 0.7 billion more than in the actual 2020 budget. This increase is due to a spike in the number of people unemployed and laid-off as a consequence of the coronavirus outbreak.

An appropriation of EUR 5.0 billion is proposed for funding pensions, or EUR 43 million more than in the actual 2020 budget.

As a result of the coronavirus epidemic, entrepreneurs' earnings are expected to drop, which would increase the central government's share of pensions paid to entrepreneurs.

An increase of EUR 5 million is proposed for appropriations reserved for the sickness allowance on account of an infectious disease in 2021.

EUR 10.4 million is proposed for the development and implementation of national information management in social welfare and healthcare.

An appropriation of EUR 0.5 million is proposed for an international gender equality award to be given every two years. The award will be next presented in 2021. The Equality and Equal Pay Programme will be continued with an appropriation of EUR 0.5 million to coordinate the measures to achieve an equal society in different areas.

A general increase of EUR 1 million is proposed for the appropriation allocated to shelter activities, which would make the annual funding around EUR 23.6 million.

A EUR 213.2 million appropriation is proposed for grants to organisations and foundations to promote health and social wellbeing. The appropriation has been reduced as a result of the uncertainty of Veikkaus' return estimate, which is mainly caused by the restrictive measures taken due to the coronavirus epidemic.

Compensation for the decline of gambling revenue

In 2021, the funding allocated to the beneficiaries of gambling revenue will correspond to the 2019 revenue level. The compensation, totalling at EUR 347 million, will be financed through lowering the lottery tax (impact on Veikkaus revenues amounts to EUR 80 million), budgetary funds (EUR 152.2 million, of which EUR 141.5 million in the administrative branch of the Ministry of Education and Culture and EUR 10.7 million in the administrative branch of the Ministry of Agriculture and Forestry) and the utilisation of previously non-distributed proceeds (EUR 114.8 million in the administrative branch of the Ministry of Social Affairs and Health).

4.3 Local government finances

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 8 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.

In 2021, the municipalities' revenue is expected to consist of tax revenue (47 %), operating income (20%), central government transfers (19%) and other revenue (13 %; incl. borrowing). It is estimated that 44 % of the municipalities' expenditure will be allocated to wages and salaries, 32 % to procurement of services and materials, 11 % to investments, and 13 % to other expenditure. The distribution of municipalities' revenue and expenditure is illustrated in Diagram 9.

The Ministry of Finance projection takes into account the measures affecting local government finances included in the General Government Fiscal plan and the budget proposal for 2021. The anticipated measures to support local government finances to be included in the seventh supplementary budget are also included in the estimate. The figures are based on the minutes of the Government's budget session.

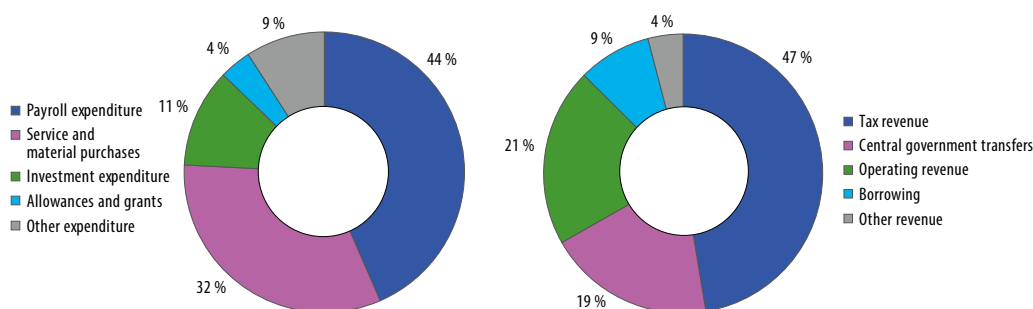


Diagram 9. Distribution of municipalities' revenue and expenditure in 2021, %

Source: Ministry of Finance

The development of the deficit and debt is illustrated in Diagram 10. The diagram shows that local government net lending is projected to be between -1% of the GDP in 2021 and debt around 11% of the GDP. These are described in more detail in chapter 2.3 of the Ministry of Finance's Economic Survey for autumn 2020. .

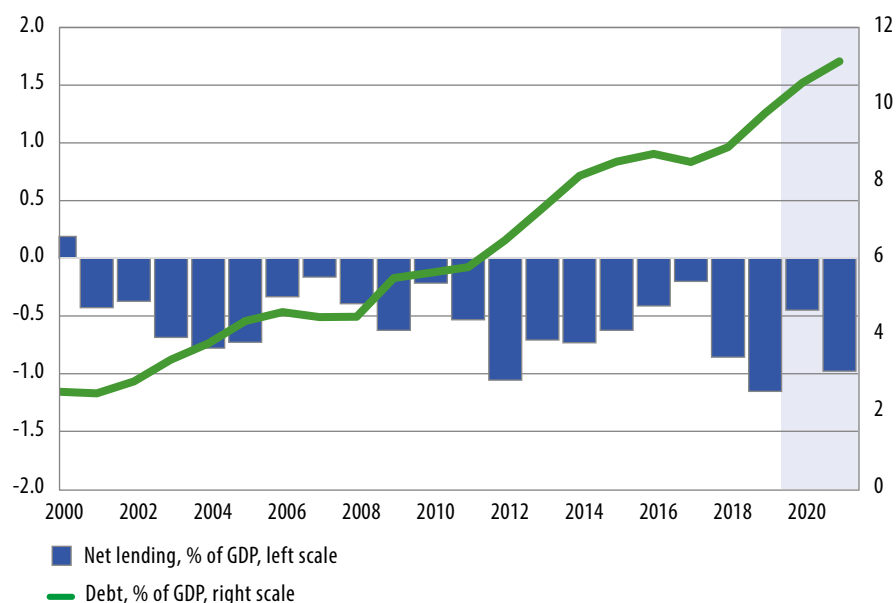


Diagram 10. Net lending and debt in the local government sector, % of GDP

Source: Statistics Finland, Ministry of Finance

Central government measures affect the municipalities' revenue and expenditure. The net impact of central government measures will strengthen local government finances in 2021.

Central government transfers to municipalities will total at around EUR 12.4 billion, which is approximately EUR 0.8 billion more than in the actual 2020 budget. In addition to the aforementioned government transfers, municipalities and hospital districts will be fully compensated for the direct costs associated with coronavirus for as long as this is necessary due to the infection situation and the implementation of the hybrid strategy. This budget proposal allocates EUR 1.66 billion for these measures in the administrative branch of the Ministry of Social Affairs and Health.

Central government transfers for municipal basic services will total at around EUR 7.7 billion, which is approximately EUR 600 million more than in the actual 2020 budget. Compared to the 2020 level, the central government transfers will be increased by, for instance, a one-off increase of EUR 300 million in central government transfers to basic services to compensate municipalities for the decline in tax revenue caused by the coronavirus situation, an index increase of EUR 174 million (2.4%) and a change in the number of inhabitants and calculation factors amounting to EUR 30.9 million.

EUR 53 million is proposed for a binding minimum staffing level for care personnel (0.7). In addition, EUR 17.9 million is proposed for reforming the Act on Client Charges in Health and Social Services, of which EUR 0.9 million is a one-off increase. While the amendment

to the Act on Client Charges in Health and Social Services will reduce the payment revenue obtained by municipalities, this reduction will be compensated by increasing the related central government transfer with a corresponding amount.

The 10 percentage points increase in corporate tax apportionment will be extended for a fixed term for 2021, which will increase the municipalities' revenue by a total of EUR 550 million, of which EUR 510 million will be allocated to 2021. The reduction in early childhood education and care fees will be compensated to municipalities by increasing the corporate tax apportionment by 2%, which will increase local government income by EUR 102 million per year.

The central government reimbursement to municipalities for tax revenue losses caused by changes in tax criteria amount to EUR 2.36 billion in 2021.

In the administrative branch of the Ministry of Education and Culture, EUR 15 million is proposed as a one-off increase for the reform of early childhood education and care in 2021, of which EUR 14.5 million will be allocated to local government finances.

In the budget proposal for 2021, local government finances are subject to significant reforms, including ones connected with the expansion of compulsory education and the binding minimum staffing level for care personnel. The impact of the reforms on local government finances will gradually increase in many tasks. Local government expenditure will increase significantly by 2024, although municipalities will receive 100% central government funding for their new and expanding tasks. For example, the impact of the binding minimum staffing level for care personnel in 2021 will total at EUR 53 million and increase to EUR 266 million by 2024. Expanding compulsory education and free upper secondary education will increase expenditure by EUR 22 million in 2021; by 2024, the level will increase to EUR 129 million. The Government's discretionary permanent measures will increase the total local government expenditure by an estimated EUR 370 million in 2021, and the expenditure will more than double to around EUR 790 million by 2024.

5 Summary

This publication examines the budget proposal for 2021.

The economic policy of Prime Minister Marin's Government has the objective of increasing wellbeing. This means ecologically and socially sustainable economic growth, high employment and sustainable public finances. The crisis caused by coronavirus created a need to specify the objectives of the government programme for the long-term stabilisation of public finances. In the first phase of the sustainability roadmap in June 2020, the Government outlined the objective of stabilising the general government debt-to-GDP ratio by the end of the decade.

The contraction caused by the coronavirus pandemic in the Finnish economy in the first half of the year was less severe than in most other European economies in the first half of 2020. Finland's gross domestic product is projected to contract by 4.5% in 2020. The employment rate will decrease to 71.5 per cent and the unemployment rate will rise to 8 per cent. The economy will gradually recover from the sudden halt occurring in the first half of 2020. GDP is expected to grow by 2.6 % in 2021. In 2021, the number of employed people will continue to slightly decrease, resulting in the projected employment rate of 71.0%.

The economic downturn triggered by the coronavirus outbreak and the measures to contain its impacts have substantially boosted Finland's general government deficit in 2020. General government finances will not return to the pre-pandemic levels when the downturn is over. The economic growth expected in the coming years will not be enough to balance the general government budgetary position and Finland's general government finances will remain substantially in deficit.

During the government term, the Government will carry out employment measures that strengthen the economy with an aim to achieve the employment impacts of 80,000 additional employed persons. The measures decided in the 2020 budget session aim at increasing the number of employed people by between 31,000 and 36,000 together with the measures already taken by the Government to increase employment and a negotiating mandate given to labour market organisations.

The total sum of the 2021 budget proposal rises to EUR 64.2 billion. The central government on-budget deficit is predicted to amount to approximately EUR 10.8 billion and central government debt is expected to rise to approximately EUR 135 billion. Expenditure will be higher due to temporary increases in expenditure related to the coronavirus situation. The expenditure will also be higher due to issues such as the increase in unemployment expenditure, statutory and contractual index increases, the central government wage agreement, and additional, previously decided investments, such as the estimated expenditure impacts of the purchase of HX fighter aircraft. The budget proposal also contains significant additional investments in local government finances.

The budget proposal for 2021 will also be updated on the www.tutkibudjettia.fi website which allows the budget to be examined visually from different perspectives.



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