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**Addendum to the assessment of the 2015 Stability Programme for  
FINLAND**

*(Note prepared by DG ECFIN staff)*

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## 1. INTRODUCTION

In its Article 126 (3) report published on 13 May 2015,<sup>1</sup> the Commission considered Finland not to be compliant with the deficit and debt criteria of the Stability and Growth Pact. This conclusion was based on the 2014 deficit outturn at 3.2% of GDP, notified by Finland and validated by Eurostat, Finland's 2015 Stability Programme (which was based on a no-policy-change assumption and presented by the outgoing government), as well as on the Commission's spring 2015 forecast which projected the headline deficit to be above 3% of GDP in 2015-2016 and the general government debt-to-GDP ratio to exceed the 60%-of-GDP treaty reference value in 2015 and to increase further in 2016. This assessment is reflected in the Commission's recommendation for a country-specific recommendation (CSR) to Finland and further explained in the assessment note of the 2015 Stability Programme for Finland.<sup>2</sup>

After the completion of the assessment of the 2015 Stability Programme, and the publication of the Commission recommendation for the CSRs, the incoming Finnish government announced fiscal consolidation measures to be implemented over 2016-19 in its Strategic Programme.<sup>3</sup> The goal of the new government is to consolidate public finances so that the upward trend in the debt-to-GDP ratio would be reversed by 2019. The government programme is sufficiently detailed regarding the content of the adjustment measures but, in contrast to the Stability Programme, does not include any fiscal targets or projections.

This document provides an assessment of the announced measures and their budgetary impact, updating the initial assessment published on 27 May.

## 2. MEASURES ANNOUNCED BY THE GOVERNMENT

According to the government's Strategic Programme of 27 May, the rebalancing of public finances will start as of 2016. The new government has not presented new measures regarding 2015. The short- and medium-run consolidation is achieved through spending cuts. The total tax rate is not planned to increase, but the growth-friendliness of taxation is planned to improve, through the reduction of taxes on labour and the increase of taxes on consumption. Moreover, the government is planning structural reforms, which are expected to promote employment, entrepreneurship, investment and economic growth.

### **Expenditure based consolidation**

The government's Strategic Programme proposes expenditure savings cumulating to 4 bn euros or (1.7% of GDP) over 2015-2019, of which 1.4 bn euros (0.6% of GDP) in 2016. These measures would include i) freezing most of the social benefits indices in 2016, and allowing only their gradual increase thereafter; ii) reducing social benefits; and iii) other reductions of government expenditure across the board (only expenditure on home security and defence would be increased).

In addition to the announced measures, the government is seeking to build a comprehensive social contract with the social partners. The purpose of this contract would be that, if the

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<sup>1</sup> [http://ec.europa.eu/economy\\_finance/economic\\_governance/sgp/pdf/30\\_edps/126-03\\_commission/2015-05-13\\_fi\\_126-3\\_en.pdf](http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/30_edps/126-03_commission/2015-05-13_fi_126-3_en.pdf)

<sup>2</sup> [http://ec.europa.eu/economy\\_finance/economic\\_governance/sgp/pdf/20\\_scps/2015/26\\_fi\\_scp\\_en.pdf](http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/20_scps/2015/26_fi_scp_en.pdf)

<sup>3</sup> <http://valtioneuvosto.fi/en/sipila/government-programme>

social partners agree on measures to reduce unit labour costs by 5% so that economic growth and employment gain momentum with a positive impact on public finances, the government stands ready to lower labour-income taxes as of 2018. If social partners do not reach an agreement on such contract, the government intends to implement additional consolidation measures amounting to 1.4 bn euros (0.6% % of GDP) in 2018. At this point in time, the discussions with the social partners have only just begun, and the government expects indications of a possible agreement by the second half of August 2015. Hence, the fiscal consolidation path for 2018 and beyond will be fully defined before autumn.

The consolidation measures, outlined in sufficient detail in Appendix 6 of the Strategic Programme, are realistic and could produce the savings as planned.

### **Structural reforms**

In addition to the consolidation measures, the Strategic Programme also focuses on structural reforms. The reforms proposed are in line with the findings of the Country Report<sup>4</sup> and the CSRs. In line with the recommendations, the government is committed to submit the pension reform agreed by the social partners in 2014 to parliament. The Strategic Programme includes a proposal for the social- and healthcare system reform.

To improve non-cost competitiveness, the government is planning measures that foster start-ups, fast-growth companies and change-of-generation in businesses. The government has committed itself not to increase the operating costs for the industry during its parliamentary term. Regarding the labour market, the government plans to reform social and unemployment benefits to increase incentives to work, shorten periods of unemployment, reduce structural unemployment and save public resources.

### **Investments in strategic priorities**

According to the Strategic Programme, 1.6 bn euros (0.7% of GDP) would be invested in key government projects by the end of 2018. The strategic objectives include employment, competitiveness and growth, the bioeconomy and clean technologies and digitalisation. As part of this package, the Government also plans to launch a programme to invest approximately 600 million euros in the transport network.

The financing and timing of these investments is not fully clear from the Strategic Programme. For the purposes of the assessment, it has been assumed that the investment programme does not increase general government deficit in 2016 compared to the spring forecast as the financing would come from the reallocation of the investment budget. It is foreseen that the EU's Strategic Investment Fund and European Investment Bank instruments would be utilised to achieve these priority-area objectives.

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<sup>4</sup> [http://ec.europa.eu/europe2020/pdf/csr2015/cr2015\\_finland\\_en.pdf](http://ec.europa.eu/europe2020/pdf/csr2015/cr2015_finland_en.pdf)

### **3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS**

#### **3.1. Deficit target for 2015 and 2016**

The Commission has performed a partial and mechanical update of its spring forecast to take these new measures into account. It is assumed that growth and deficit developments in 2015 will remain the same as in the 2015 spring forecast. Regarding 2016, the Commission considers the measures to lower GDP growth to 0.6%, compared to 1% GDP growth in the spring forecast. Growth will be lower on account of lower consumption caused by a slower growth of disposable income and lower government consumption expenditure.

If the planned expenditure measures are implemented as outlined in the Strategic Programme, the general government deficit would fall well below the 3% reference value, on the back of measures worth about 0.6% of GDP, in 2016 (compared to a no-policy-change spring 2015 forecast of a deficit of 3.2% in 2016).

#### **3.2. Debt developments**

The general government debt-to-GDP ratio in 2016 would grow by less than projected in the Commission 2015 spring forecast. Instead of 64.8%, the ratio would increase to 64.5% in 2016. The general government gross consolidated debt ratio would continue to increase to about 67% of GDP in 2019, before coming slowly down thereafter.

#### **3.3. Risk assessment**

The Strategic Programme does not include additional measures for 2015. However, according to recent tax authority data, corporate-income-tax receipts have been higher than anticipated in early 2015, as corporations paid more tax for the revenues related to 2014. This could, *ceteris paribus*, lead to a downward revision of the projection for deficit for 2015, thus presenting an upside risk for the fiscal balance in 2015, with a carry-over to 2016.

The Commission's assessment does not take into account the possible benefits of the structural reforms that could be apparent already in 2016. As an example, lower taxation on labour income and reduced benefits could increase the supply of labour already in 2016. This also forms an upside risk for the assessment.

On the other hand, the impact of some measures may turn out lower than estimated in the Strategic Programme or there could be delays in the implementation. The Strategic Programme plans to improve tax collection by 150 million euros from extending the corporate-income-tax base and fighting the shadow economy. Taking into account that the previous government has already taken measures against the shadow economy, it might be difficult to reach these gains. Also, due to the pre-existing agreement with the labour-market partners, the planned 200 million euros reduction in unemployment benefits would be implemented only as of 2017. Unless the government finds other areas to reduce expenditure, the fiscal adjustment will be 0.1% lower in 2016.

## **4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT**

### **4.1. Compliance with the deficit and debt criterion**

According to the assessment by the Commission, the measures announced by the new government would bring the deficit in 2016 well below 3% of GDP. Thus, the deficit in 2014 and 2015 would remain close to the reference value and the excess could be considered temporary in the sense that it returns below the reference value over the forecast horizon, while in 2014 it was also deemed to be exceptional.

The announced measures are insufficient to reduce the debt-to-GDP ratio in 2016, but the growth of debt-to-GDP ratio will be lower than previously expected. In this respect it has to be noted that, based on the announced measures, the excess over 60% of GDP in 2016 would not be fully explained by the support provided to other euro-area Member States (2.9% of GDP in 2016), unlike in 2015.

### **4.2. Compliance with the MTO or the required adjustment path towards the MTO**

As on the basis of the above elements there appears to be no need to open the EDP for Finland at this stage, the country will remain in the preventive arm. Therefore, compliance with the required adjustment towards the MTO is assessed below, in light of the new measures presented by Finland.

Finland was at its MTO (-0.5% of GDP) in the beginning of 2014, but deviated from it in the course of 2014 on the back of deterioration of the structural balance by -0.8% of GDP. In 2015, according to the Commission's 2015 spring forecast, the structural balance would deteriorate further (-0.2% of GDP) whereas the requirement is an improvement of 0.1% of GDP. On the basis of the expenditure-benchmark pillar, Finland has respected the requirement in 2014-2015. Based on the overall assessment, there may be a risk of a significant deviation from the required adjustment towards the MTO over 2014-2015 taken together, which will need to be reassessed ex post taking into consideration whether the economic situation of the country in 2014 (i.e. negative real growth) justifies the observed loosening of the structural balance.

In 2016, given the announced measures, the structural-balance pillar points to some deviation, while the expenditure-benchmark pillar points to compliance. In 2016, the structural balance reflects better the potential growth rate of the economy than the medium-term growth rate used in the expenditure benchmark. Following an overall assessment, in 2016 there is a risk of some deviation from the requirements.

**Table 1: Compliance with the requirements under the preventive arm**

(% of GDP)	2014	2015	2016
<b>Initial position<sup>1</sup></b>			
Medium-term objective (MTO)	-0.5	-0.5	-0.5
Structural balance <sup>2</sup> (COM)	-1.6	-1.9	-1.5
Structural balance based on freezing (COM)	-0.9	-1.8	-
<b>Position vis-a-vis the MTO<sup>3</sup></b>	At or above the MTO	Not at MTO	Not at MTO
(% of GDP)	<b>2014</b>	<b>2015</b>	<b>2016</b>
<b>Structural balance pillar</b>			
Required adjustment <sup>4</sup>	0.0	0.1	0.5
Change in structural balance <sup>5</sup>	-0.8	-0.2	0.4
<i>One-year deviation from the required adjustment after considering the relevant factors<sup>6</sup></i>	-0.8	-0.3	-0.1
Two-year average change in structural balance <sup>5</sup>	-0.2	-0.5	-0.2
<b>Expenditure benchmark pillar</b>			
Applicable reference rate <sup>7</sup>	0.8	0.6	-0.1
<i>One-year deviation<sup>8</sup></i>	0.4	0.4	0.4
<i>Two-year average deviation<sup>8</sup></i>	0.6	0.4	0.4
<b>Conclusion</b>			
Conclusion over one year	Overall assessment	Overall assessment	Overall assessment
Conclusion over two years	Overall assessment	Overall assessment	Overall assessment
Notes			
<p><sup>1</sup> The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.</p> <p><sup>2</sup> Structural balance = cyclically-adjusted government balance excluding one-off measures.</p> <p><sup>3</sup> Based on the relevant structural balance at year t-1.</p> <p><sup>4</sup> Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 28.).</p> <p><sup>5</sup> Change in the structural balance compared to year t-1. Ex post assessment (for 2013) is carried out on the basis of Commission 2014 spring forecast.</p> <p><sup>6</sup> The difference of the change in the structural balance and the required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.</p> <p><sup>7</sup> Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t. The reference rates applicable to 2014 onwards have been updated in 2013.</p> <p><sup>8</sup> Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.</p> <p><i>Source:</i> Commission calculations</p>			

## 5. CONCLUSIONS

Taking into account the new government's Strategic Programme of 27 May and the planned consolidation measures, the 2016 headline deficit as well as the structural balance are expected to improve in comparison with the no-policy-change 2015 Stability Programme and the Commission's 2015 spring forecast. When the new measures are accounted for, the headline deficit would remain below the reference value in 2016 and the debt-to-GDP ratio would amount to 64.5% compared to 64.8% in the spring forecast.

Based on the new information, no further steps under Article 126 of the Treaty are envisaged at this point in time.

After a deterioration of the structural balance in 2014, there is another deviation from the required structural effort under the preventive arm in 2015. There may thus be a risk of a significant deviation from the required adjustment towards the MTO over 2014-2015, which will need to be reassessed ex post taking into consideration whether the economic situation of the country in 2014 (i.e. negative real growth) justifies the observed loosening of the structural balance. In 2016, taking into account the measures announced by the incoming government, there is a risk of some deviation.

The Commission's 2015 autumn forecast will provide an opportunity to fully assess the measures, as these will be included in the Draft Budgetary Plan. The Finnish authorities have also committed to update the Stability Programme in autumn 2015.