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COMMISSION STAFF WORKING PAPER

Analysis by the Commission services of the budgetary situation in Finland in view of a possible abrogation of Council Decision 2010/408/EU on the existence of an excessive deficit in Finland

Accompanying the document

Recommendation for a Council Decision

abrogating Decision 2010/408/EU on the existence of an excessive deficit in Finland

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1. INTRODUCTION

In response to the economic downturn and given the existing comfortable fiscal space, Finland allowed a full operation of the automatic stabilisers and provided a discretionary fiscal stimulus, in line with the European Recovery Plan. As a result the general government finances turned from earlier surpluses into a deficit of 2.5% of GDP in 2009. The deficit was projected to widen further to 4.1% of GDP in 2010 according to the April 2010 EDP notification presented by the Finnish Ministry of Finance. The Commission services' spring 2010 forecast projected a slightly smaller deficit of 3.8% of GDP in 2010. Against this background, on 13 July 2010, the Council decided that an excessive deficit existed and addressed a recommendation to Finland in accordance with Article 126(7) TFEU with a view to bringing an end to the situation of an excessive government deficit by 2011.[1] In its recommendation, the Council established a deadline of 13 January 2011 for effective action to be taken.

The Council recommended Finland to bring the general government deficit below 3% of GDP in a credible and sustainable manner by 2011 at the latest. Specifically, to this end, Finland should: "(a) implement the fiscal measures in 2010 as envisaged in the latest update of the stability programme, while ensuring that the planned breach of the 3%-of-GDP reference value would remain contained and temporary; (b) ensure a fiscal effort of at least 0.5% of GDP in 2011; and (c) specify measures to ensure that the planned correction of the excessive deficit in 2011 is secured."

On 27 January 2011, i.e. after the 6-months deadline for taking action set in the Council recommendation, the Commission carried out an assessment of the action taken by the Finnish authorities with a view to bringing the situation of excessive government deficit to an end. On that basis, it adopted a communication to the Council, which concluded that Finland had taken action representing adequate progress towards the correction of the excessive deficit within the time limits set by the Council and that no further steps in the excessive deficit procedure of Finland were necessary at that time. In its meeting of 15 February 2011, the Council concurred with this assessment.

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1 All EDP-related documents for Finland can be found at the following website: http://ec.europa.eu/economy_finance/sgp/deficit/countries/finland_en.htm

The following section reviews the budgetary situation in Finland on the basis of data provided by the Commission (Eurostat)[2], following the reporting by Finland before 1 April 2011, as well as the Commission services' spring 2011 forecast. It also takes into account the medium-term budgetary plans, as reported in the 2011 update of the stability programme of Finland.

2. ECONOMIC DEVELOPMENTS AND BUDGETARY SITUATION

The 2009/2010 update of the stability programme, published in February 2010 targeted a general government deficit of 3.6% in 2010, while expecting annual GDP growth to amount to 0.7%. In its EDP notification of April 2010, the Finnish authorities reported a slightly weaker budgetary target still, with a planned deficit of 4.1% of GDP in 2010. These projections, made in the early part of 2010 when the impact of the economic crisis was still dominant, turned out to be too pessimistic. Actual real GDP growth amounted to 3.7% in 2010 and the general government recorded a deficit of 2.5% of GDP. The stronger-than-expected outcome in public finances is primarily explained by more robust economic growth and an improved labour market situation boosting tax revenues (notably VAT and income tax), while expenditure growth remained overall contained compared to plans.

The 2011 update of the stability programme foresees GDP to grow by 3.6% in 2011 and 2.7% in 2012, driven especially by domestic demand and to a lesser extent supported by net exports. The Commission services' spring 2011 forecast projects a similar GDP growth pattern for 2011-2012 (see Table 1).

Table 1. Comparison of macroeconomic developments and forecasts

	2010		2011		2012		2013	2014	2015
	COM	SP	COM	SP	COM	SP	SP	SP	SP
Real GDP (% change)	3.1	3.1	3.7	3.6	2.6	2.7	2.4	2.1	1.9
Private consumption (% change)	2.6	2.6	2.3	2.1	2.0	1.8	2.3	2.3	2.2
Gross fixed capital formation (% change)	0.8	0.8	6.6	7.2	4.5	4.7	2.9	2.6	2.2
Exports of goods and services (% change)	5.1	5.1	8.5	7.8	5.5	5.5	4.3	4.5	4.5
Imports of goods and services (% change)	2.6	2.6	7.2	6.7	5.1	4.7	3.9	3.5	3.5
Contributions to real GDP growth:									
- Final domestic demand	1.7	1.7	2.7	2.7	2.1	2.0	2.0	1.8	1.7
- Change in inventories	0.7	0.5	0.3	0.3	0.2	0.3	0.1	-0.3	-0.4
- Net exports	1.0	1.0	0.7	0.6	0.3	0.5	0.3	0.6	0.6
Output gap[1]	-5.3	-4.9	-3.5	-2.9	-2.7	-1.7	-0.7	0.0	0.6
Employment (% change)	-0.4	-0.4	0.9	1.7	0.7	0.9	0.6	0.1	0.0
Unemployment rate (%)	8.4	8.4	7.9	7.6	7.4	7.2	6.9	6.5	6.3
Labour productivity (% change)	3.5	3.5	2.7	1.8	1.9	1.8	1.8	2.0	1.9
HICP inflation (%)	1.7	1.7	3.6	3.0	2.2	2.4	2.0	2.0	2.0
GDP deflator (% change)	2.1	2.1	2.5	2.7	2.4	2.4	2.1	2.1	2.1
Comp. of employees (per head, % change)	2.0	2.3	2.8	2.7	3.4	3.2	3.4	3.7	3.7
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	2.9	3.2	2.6	2.3	2.6	2.2	2.0	2.0	2.0

Note:

[1]In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.

Source:

Commission services' spring 2011 forecasts (COM); Stability programme (SP).

[2] Eurostat news release 60/2011 of 26 April 2011.

Whereas the 2009/2010 update of the stability programme targeted a general government deficit of 3.0% of GDP for 2011, the latest stability programme update projects a deficit of 0.9% of GDP in 2011. Similarly, the Commission services' spring 2011 forecast projects a deficit of 1% of GDP. This is mainly due to the better-than-expected fiscal outcome of the previous year carrying over to 2011 and to a lesser extent due to an upward revision of revenue growth and a small downward revision of expenditure growth projections, reflecting the improvement in economic conditions. Since the publication of the 2009/2010 update of the stability programme, the government has decided to raise several taxes (notably energy and some product taxes, and pension insurance contribution rates), worth more than 0.5 % of GDP in 2011.

The 2011 update of the stability programme projects the headline general government deficit to improve marginally to 0.7% of GDP in 2012 and to subsequently deteriorate slightly to a deficit of 0.9% of GDP in 2013-2015 (see Table 2). The update also projects both the revenue and expenditure shares of GDP remain broadly unchanged over the period 2012-2015.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2010	2011		2012		2013	2014	2015	Change: 2010-2015
	COM	COM	SP	COM	SP	SP	SP	SP	SP
Revenue	**52.3**	**52.8**	**52.9**	**52.9**	**52.8**	**52.6**	**52.5**	**52.4**	**0.1**
of which:									
- Taxes on production and imports	13.4	13.8	13.7	13.8	13.6	13.4	13.3	13.2	-0.2
- Current taxes on income, wealth, etc.	15.9	16.1	16.2	16.1	16.1	16.0	16.0	16.0	0.1
- Social contributions	12.6	12.5	12.4	12.6	12.5	12.6	12.7	12.7	0.1
- Other (residual)	10.5	10.4	10.6	10.4	10.6	10.6	10.5	10.5	0.0
Expenditure	**54.8**	**53.7**	**53.8**	**53.5**	**53.5**	**53.6**	**53.4**	**53.4**	**-1.4**
of which:									
- Primary expenditure	53.7	52.6	52.4	52.2	52.0	51.9	51.6	51.5	-2.2
of which:									
Compensation of employees	14.4	13.9	13.8	13.6	13.5	13.3	13.2	13.1	-1.3
Intermediate consumption	11.0	10.9	10.9	10.9	10.8	10.8	10.8	10.9	-0.1
Social payments	20.8	20.3	20.2	20.3	20.3	20.3	20.3	20.3	-0.5
Subsidies	1.5	1.5	1.5	1.5	1.5	1.4	1.4	1.4	-0.1
Gross fixed capital formation	2.7	2.6	2.6	2.5	2.5	2.5	2.4	2.4	-0.3
Other (residual)	3.4	3.3	3.4	3.4	3.5	3.5	3.5	3.4	0.0
- Interest expenditure	1.1	1.2	1.4	1.4	1.5	1.7	1.8	1.9	0.8
General government balance (GGB)	**-2.5**	**-1.0**	**-0.9**	**-0.7**	**-0.7**	**-0.9**	**-0.9**	**-0.9**	**1.6**
Primary balance	**-1.4**	**0.2**	**0.5**	**0.7**	**0.8**	**0.8**	**0.9**	**1.0**	**2.4**
One-off and other temporary measures	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
GGB excl. one-offs	**-2.4**	**-1.0**	**-0.9**	**-0.7**	**-0.7**	**-0.9**	**-0.9**	**-0.9**	**1.5**
Output gap[1]	-5.3	-3.5	-2.7	-2.7	-1.4	-0.4	0.4	1.0	6.3
Cyclically-adjusted balance[1]	0.2	0.8	0.4	0.7	0.0	-0.7	-1.1	-1.4	-1.6
Structural balance[2]	**0.3**	**0.8**	**0.4**	**0.7**	**0.0**	**-0.7**	**-1.1**	**-1.4**	**-1.7**
Change in structural balance		*0.5*	*0.1*	*-0.1*	*-0.4*	*-0.7*	*-0.4*	*-0.3*	
Structural primary balance[2]	1.4	2.0	1.8	2.1	1.5	1.0	0.7	0.5	-0.9
Change in structural primary balance		*0.6*	*0.5*	*0.0*	*-0.3*	*-0.5*	*-0.3*	*-0.2*	

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the information in the programme.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source :

Stability programme (SP); Commission services' spring 2011 forecasts (COM); Commission services' calculations

In 2011, the structural balance (according to the Commission services' spring 2011 forecast and as recalculated by the Commission services on the basis of the information in the latest stability programme update, using the commonly agreed methodology) is projected to be more favourable than the medium term objective (MTO), defined by the national authorities as a structural surplus of 0.5% of GDP. However, the structural balance is estimated to turn negative over the medium term. The estimated decline in the structural balance estimate results from a broadly unchanged headline deficit against the background of the expected favourable economic conditions closing the currently large output gap. As a result, and unless further measures are taken, in 2015 the budget balance net of cyclical factors and one off and other temporary measures is currently estimated to move slightly below the minimum benchmark of -1.2% of GDP which under normal cyclical fluctuations ensures a safety margin against breaching the 3% of GDP reference value. The 2011 update of the stability programme does not include any possible fiscal measures of the new government that took office after the mid-April elections[3].

The Commission services’ spring 2011 forecast projects the debt ratio to climb from 48.4% of GDP in 2010 to 52.2% of GDP in 2012. The stability programme update projects the debt ratio to increase to 51.3% of GDP by 2012.

[3] In its government programme, the new government commits to improve the fiscal balance by 2.5 billion euros (1.3% of GDP) by 2015, split evenly between revenue and expenditure measures. The government is also committed to implement new additional adjustment measures, if the ratio of central government debt is not foreseen to start to decline and the central government deficit is foreseen to stay above 1 % of GDP.