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REPORT FROM THE COMMISSION

Finland

Report prepared in accordance with Article 126(3) of the Treaty

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1. INTRODUCTION

Article 126 of the Treaty on the Functioning of the European Union (TFEU) lays down the excessive deficit procedure (EDP). This procedure is further specified in Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure[1], which is part of the Stability and Growth Pact (SGP). Specific provisions for euro area Member States under EDP are laid down in Regulation (EU) No 473/2013[2].

According to Article 126(2) TFEU, the Commission has to monitor compliance with budgetary discipline on the basis of two criteria, namely: (a) whether the ratio of the planned or actual government deficit to gross domestic product (GDP) exceeds the reference value of 3% (unless either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value); and (b), whether the ratio of government debt to GDP exceeds the reference value of 60% (unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace).

Article 126(3) TFEU provides that if a Member State does not fulfil the requirements under one or both of the above criteria the Commission has to prepare a report. This report also has to "*take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State*".

This report, which represents the first step in the EDP, analyses Finland's compliance with the deficit and debt criterion of the Treaty, with due regard to the economic background and other relevant factors.

Following the amendments to the Stability and Growth Pact in 2011, the debt requirement has been put on an equal footing with the deficit requirement in order to ensure that, for countries with a debt-to-GDP ratio above the 60% reference value, the ratio is brought below (or sufficiently declining towards) that value.

On 13 January 2015 the Commission adopted a Communication on Flexibility[3], providing new guidance on how to apply the existing rules of the Stability and Growth Pact, in order to strengthen the link between effective implementation of structural reforms, investment, and

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[1] OJ L 209, 2.8.1997, p. 6. The report also takes into account the "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 3 September 2012, available at: http://ec.europa.eu/economy_finance/economic_governance/sgp/legal_texts/index_en.htm.

[2] Regulation (EU) No 473/2013 of the European Parliament and of the Council on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area (OJ L 140, 27.5.2013, p. 11).

[3] Commission Communication on making the best use of the flexibility within the existing rules of the Stability and Growth Pact – COM(2015) 12 final.

fiscal responsibility in support of jobs and growth. The Communication does not amend any provision of the Pact but aims to further reinforce the effectiveness and understanding of its rules and develop a more growth-friendly fiscal stance in the euro area by ensuring the best use of the flexibility enshrined within the Pact, while preserving its credibility and effectiveness in upholding fiscal responsibility. In particular, the Communication clarified that – in line with the provisions of Article 2(3) of Council Regulation (EC) No 1467/97 - the Commission – in the context of a report pursuant to Article 126(3) TFEU - will analyse carefully all relevant medium-term developments regarding the economic, budgetary and debt positions. It has also clarified that the implementation of structural reforms in the context of the European Semester is to be considered among these relevant factors.

This report updates the Commission's previous assessment of the excess of the deficit and debt ratio over the Treaty reference values of 16 November 2015[4]. The November report concluded that overall the deficit and the debt criteria of the Treaty were considered to be complied with. On 14 April 2016, Finland submitted its stability programme for 2017 – 2020.

General government debt amounted to 63.1% of GDP in 2015, above the 60%-of-GDP reference value. Both the stability programme and the Commission 2016 spring forecast indicate that the gross debt ratio is expected to continue to rise in 2016 and 2017. The notified debt-to-GDP ratio in 2015 provides evidence of a *prima facie* existence of an excessive deficit in Finland in the sense of the Treaty and the Stability and Growth Pact, before, however, considering all relevant factors as set out below.

The Commission has therefore prepared this report to comprehensively assess the excess over the Treaty reference values, in order to examine whether they are complied with after all relevant factors have been considered. Section 2 of the report examines the deficit criterion, Section 3 the debt criterion and Section 4 deals with the relevant factors. The report takes into account the Commission 2016 spring forecast released on 3 May 2016.

2. DEFICIT CRITERION

According to the spring 2016 notification, Finland's deficit amounted to 2.7% of GDP in 2015. The deficit will remain below the Treaty reference value until 2017 both based on the stability programme and on the Commission 2016 spring forecast. According to the Commission forecast, the deficit will decline to 2.5% of GDP in 2016 and to 2.3% of GDP in 2017, based on the usual no-policy change assumption. According to the stability programme, the deficit would decline to 2.1% of GDP by 2017. Hence, the deficit criterion in the Treaty is fulfilled.

3. DEBT CRITERION

The general government gross debt-to-GDP ratio increased rapidly over the recent years, growing from 32.7% of GDP in 2008 to 63.1% in 2015, on the back of high deficits with respect to nominal GDP developments and stock-flow adjustments arising from the financial investments of the earnings-related social security funds. The deficit and the stock-flow adjustment contributed roughly equally to the growth of nominal debt over these years.

[4] COM(2015) 803 final, http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/30_edps/126-03_commission/2015-11-16_fi_126-3_en.pdf

Finland's stability programme envisages the public debt ratio to increase to 65.0% of GDP in 2016 and to continue increasing to 66.7% of GDP in 2017. The debt-to-GDP ratio is planned to peak in 2018-19 and reach 67.4%. Thereafter, it is planned to marginally decline to 67.2% in 2020. According to the Commission 2016 spring forecast, public debt is expected to reach 65.2% of GDP in 2016 and grow to 66.9% of GDP in 2017 (Table 1).

According to the Commission forecast, the projected nominal growth is insufficient to offset the impact of interest expenditure on the debt ratio in 2016, resulting in a small debt-increasing snowball effect. By 2017 however, the snowball effect is set to fade out. The role of stock-flow adjustments declines over the forecast horizon, as the surplus of the social security funds is expected to diminish.

The analysis above thus suggests that, before consideration is given to all relevant factors, the debt criterion in the sense of the Treaty and Council Regulation (EC) No 1467/97 appears not to be fulfilled based on Finland's 2016 stability programme as well as the Commission 2016 spring forecast.

Table 1: Debt dynamics[a]

	2012	**2013**	**2014**	**2015**	**2016**	**2017**
Government gross debt ratio	52.9	55.5	59.3	63.1	65.2	66.9
Change in debt ratio [b] (1 = 2+3+4)	4.4	2.5	3.9	3.8	2.1	1.7
Contributions:						
• Primary balance (2)	0.8	1.4	1.9	1.5	1.4	1.1
• "Snowball" effect (3)	0.7	0.3	0.7	0.7	0.2	0.0
of which:						
Interest expenditure	1.4	1.3	1.2	1.2	1.2	1.1
Real GDP growth	*0.7*	*0.4*	*0.4*	*-0.3*	*-0.4*	*-0.5*
Inflation (GDP deflator)	-1.4	-1.3	-0.9	-0.2	-0.5	-0.6
• Stock-flow adjustment (4)	3.0	0.8	1.2	1.6	0.5	0.5

Notes:

[a] In percent of GDP.

[b] The change in the gross debt ratio can be decomposed as follows:

$$\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \left(\frac{D_{t-1}}{Y_{t-1}} * \frac{i_t - y_t}{1 + y_t} \right) + \frac{SF_t}{Y_t}$$

where t is a time subscript; D, PD, Y and SF are the stock of government debt, the primary deficit, nominal GDP and the stock-flow adjustment respectively, and i and y represent the average cost of debt and nominal GDP growth. The term in parentheses represents the "snow-ball" effect, measuring the combined effect of interest expenditure and economic growth on the debt ratio.

Source: Eurostat and Commission 2016 spring forecast

4. RELEVANT FACTORS

Article 126(3) TFEU stipulates that the Commission's report "*shall also take into account whether the government deficit exceeds government investment expenditure and take into account other relevant factors, including the medium-term economic and budgetary position of the Member State in order to decide whether the breach of the criterion merits the launch of an EDP for the Member State in question.*" These factors are further clarified in Article 2(3) of Council Regulation (EC) No 1467/97, which also specifies that "*any other factors which, in the opinion of the Member State concerned, are relevant in order to comprehensively assess in qualitative terms the excess over the reference value and which the Member State has put forward to the Council and the Commission*" need to be given due consideration.

The following subsections consider in turn: (1) the medium-term economic position; (2) the medium-term budgetary position including an assessment of compliance with the required adjustment towards the medium-term budgetary objective (MTO) and the development of public investment; (3) the developments in the medium-term government debt position, its dynamics and sustainability; (4) other factors considered relevant by the Commission; and (5) other factors put forward by the Member State.

The report reflects the factors mentioned above based on the notified data and the Commission 2016 spring forecast.

4.1. Medium-term economic position

Cyclical conditions and potential growth

After Finland's real GDP collapsed by 8.3% in 2009, the country recovered gradually in 2010 and 2011, but experienced a new recession over 2012-14. In 2015, GDP increased by 0.5%. The growth outlook is expected to improve in 2016 and 2017 (Table 2). The prolonged downturn has negatively affected Finland's potential growth. Estimated in accordance with the commonly-agreed methodology, potential growth averaged 0.1% over 2009 to 2015, being negative (at -0.1%) in 2013 and 2014. In 2016, potential output growth is estimated to remain unchanged from 2015 whereas in 2017 it is estimated at 0.4%. The contraction of potential output has been caused by declining contributions of labour inputs and the estimated negative contribution of total factor productivity, which reflects the ongoing restructuring of the economy. Moreover, the positive contribution of capital also declined over the crisis period, due to lower investment. Overall, real GDP in 2015 was 5.3% below the level recorded in 2008, whereas potential output grew by just 0.5% in total over 2009-2015 period. This could be explained by the restructuring process, in which the electronics industry has lost its important role in the Finnish economy and other industries, often with lower productivity levels, expand their capacity to fill the void. The 2016 Country Report for Finland has emphasized the endowment of human capital, stable institutional framework and good conditions for doing business as fundamental strengths that should contribute to total factor productivity growth in the future.

With real GDP below potential over 2012-14, the output gap widened to -2.8% of potential GDP in 2014 and is estimated to have reached -2.3% in 2015 as GDP grew above potential. In 2016, GDP growth is also forecast to remain above potential growth, reducing the output gap to -1.6% of GDP.

Table 2: Macroeconomic and budgetary developments[a]

	2012	2013	2014	2015	2016		2017	
	COM	COM	COM	COM	COM	National authorities	COM	National authorities
Real GDP (% change)	-1.4	-0.8	-0.7	0.5	0.7	0.9	0.7	1.4
Potential GDP (% change)	0.0	-0.1	-0.1	0.0	0.0	0	0.4	0
Output gap (% of potential GDP)	-1.6	-2.3	-2.8	-2.3	-1.6	-1.9	-1.2	-1.2
General government balance	-2.2	-2.6	-3.2	-2.7	-2.5	-2.5	-2.3	-2.1
Primary balance	-0.8	-1.4	-1.9	-1.5	-1.4	-1.4	-1.1	-1.0
One-off and other temporary measures	-0.1	-0.1	0.1	0.0	0.0	0.0	0.0	0.0
Government gross fixed capital formation	4.0	4.2	4.1	4.0	4.1	4.1	4.1	4.1
Cyclically-adjusted balance	-1.2	-1.3	-1.6	-1.4	-1.6	-1.5	-1.5	-1.4
Cyclically-adjusted primary balance	0.2	0.0	-0.3	-0.2	-0.5	-0.3	-0.4	-0.3
Structural balance [b]	-1.2	-1.2	-1.6	-1.4	-1.6	-1.5	-1.5	-1.4
Structural primary balance	0.3	0.0	-0.4	-0.2	-0.5	-0.3	-0.4	-0.3

Notes:

[a] In percent of GDP unless specified otherwise.

[b] Cyclically-adjusted balance excluding one-off and other temporary measures.

Source: Eurostat and European Commission 2016 spring forecast, 2016 Draft Budgetary Plan

When corrected for the effects of the cycle over the last three years, the debt ratio in 2015 remained below the Treaty reference value, but this is no longer expected to be the case in 2016. Based on the Commission 2016 spring forecast, cyclically-adjusted debt is estimated at 61.8% of GDP in 2016 and 65.0% in 2017 (Table 3).

Table 3: General government deficit and debt (% of GDP)

		2012	2013	2014	2015	2016		2017	
						COM	National authorities	COM	National authorities
Deficit criterion	General government balance	-2.2	-2.6	-3.2	-2.7	-2.5	-2.5	-2.3	-2.1
Debt criterion	General government gross debt	52.9	55.5	59.3	63.1	65.2	65.0	66.9	66.7
	General government gross debt adjusted for the effect of the cycle				58.5	61.8		65.0	

Sources: Eurostat, European Commission 2016 spring forecast, 2016 Stability Programme, data communicated by the national authorities

Recent structural reforms

Finland has implemented structural reforms with the view to reducing government expenditure and to increase the growth potential of the economy. The pension reform eventually linking the statutory retirement age to life expectancy has been enacted and will start to have impact as of 2017. The government has announced its orientations regarding the updated plan to reform the healthcare and social services, in order to bring their expenditure growth under control.

Pensions. The most important recent reform is the pension reform legislated at the end of 2015 which enters into force in 2017. The reform links the retirement age to life expectancy as recommended by the Council. According to the national authorities, the reform is expected to improve long-term fiscal sustainability. No decision has been taken under the current pension reform regarding the extended unemployment benefits for workers close to the retirement age. This could limit the positive impact that the pension reform is expected to have on the labour supply, as older unemployed will remain eligible for unemployment benefits until reaching the pension age.

Labour market. On an aggregate level, wage increases have been moderate since the centrally agreed wage deal of late 2013 that has been extended into 2016. However, in the low inflation and low growth environment, the strategy of restoring cost competitiveness through low wage adjustments has had only a limited effect. On 29 February 2016, the central labour market organisations reached an agreement, refered to as the Competitiveness Pact, to increase, from 2017, annual working time without additional compensation, not to carry out any centrally agreed wage increases in 2017 and to shift social security contributions more towards the employees. Public sector employees' holiday bonuses would be temporarily reduced by 30%. There is also an intention to extend the possibilities for local bargaining. Employer and employee organisations have started sectoral collective agreement negotiations on introducing the terms of the Competitiveness Pact into industry level agreements. These will determine whether the Pact will be implemented.

In parallel, the government launched in April 2016 a reform of unemployment security aimed at encouraging quick acceptance of job offers and tightening the obligation to accept work as well as the obligation to participate in employment-promoting activation measures. In addition, shortening the duration of earnings-related unemployment security by one fourth is foreseen. In 2017 and 2018, unemployment benefits may, under certain conditions, be used to finance mobility grants, start-up grants and wage subsidies.

Administrative reform. The government is advancing the reform proposal for improving the arrangement of social and healthcare services. The government aims at preparing the legislative proposals by the end of 2016 and to implement the reform from 2019 onwards.The aim is to reduce health disparities and to better control the costs. A regional government (county) system will be established, led by councils elected by direct elections. In addition to social and healthcare services, the counties would also be given other duties such as rescue services, environmental healthcare, regional development and business-promotion and land-use management. The reform will extend the freedom of choice of social welfare and healthcare services, thus also promoting competition in the provision of social and healthcare services. The social and healthcare services reform aims to achieve total savings of EUR 3 billion (1.5% of GDP) in the long term through the comprehensive integration of social and healthcare services, larger entities in charge of providing the services than at present, and digitalisation.

Services markets. The most significant legislative change in the retail sector has been the liberalisation of the opening hours of shops from the beginning of 2016. At the beginning of February 2016, an amendment to the Land Use and Building Act came into force. This will accelerate regional land use planning and increase the opportunities for regional councils to react more quickly to changes in the operating environment of the wholesale and retail trade.

4.2. Medium-term budgetary position

Structural deficit and fiscal consolidation

In 2015, the structural balance improved by 0.2 pp of GDP, exceeding the recommended adjustment towards the MTO, and the expenditure benchmark was met with a margin of 0.7% of GDP. Therefore, Finland was compliant with the requirements of the preventive arm in 2015.

In 2016, the structural balance is set to worsen by 0.2pp, pointing to a risk of a significant deviation (gap of -0.7% of GDP) from the required adjustment of 0.5% of GDP. The expenditure benchmark is met. This calls for an overall assessment. On the one hand, the current estimate of potential GDP growth underlying the structural balance estimate (0.0%) is lower than the medium-term average used in the expenditure benchmark (0.8%, frozen based on the Commission 2013 winter forecast). The latter can no longer be considered fully relevant given that the prolonged downturn has durably affected Finland's medium-term growth prospects. Indeed, if the medium-term potential growth rate underlying the expenditure benchmark were to be updated based on the data in the Commission 2015 spring forecast (as will be the approach from 2017 onwards), the expenditure benchmark would not be fully met but would indicate some deviation from the adjustment path towards the MTO. On the other hand, the difference between the signals given by the two pillars also reflects the effects of lower than expected inflation. In the draft budgetary plan for 2016, submitted in November 2015, the GDP deflator was forecast at 1.2%. A similar forecast was made by the Commission in autumn 2015. In the 2016 spring forecast, the GDP deflator is forecast at 0.8%. This negatively affects public revenues through reduced tax collection. Although most of the social security transfers are indexed to the CPI, for 2016 there was already a previous decision to freeze the index adjustments. Therefore the lower-than-expected inflation has had less of an impact on the public expenditures and the overall impact on the general government balance has been negative. Whereas during the time of the preparation of the 2016 budget the headline balance was expected to improve by 0.5 pp (in the Commission 2015 autumn 2015 forecast), the improvement based on the spring 2016 forecast is 0.2pp. Although the lower improvement in the headline balance is partly explained by the additional immigration-linked expenditure that was added to the 2016 budget proposal after the draft budgetary plan was presented, the lower improvement in headline balance is also the result of the lower inflation. In addition, there are no windfall gains for the Finnish public sector from the low interest rate environment, because the lower interest expenditure is more than offset by the lower interest revenues received by the social security funds. Taking into account these factors, the structural balance pillar would indicate some deviation from the adjustment path towards the MTO.

Considering these factors, the overall assessment points to a risk of some deviation from the recommended adjustment path towards the MTO in 2016. In its 2016 Stability Programme, Finland requested that expenditure linked to additional immigration, amounting to 0.2% of GDP would be taken into account while assessing the progress towards the MTO. If this estimate of the increase in refugee-related expenditure was excluded from the deficit, the conclusion of the overall assessment would remain unchanged.

Government expenditure and investment

Government investment as a share of GDP has increased since 2008 when gross fixed capital formation by the government sector amounted to 3.6% of GDP. In 2015 it amounted to 4.0%

of GDP in 2015. According to the stability programme, investment is expected to amount to 4.1% of GDP in 2016 and 2017. Throughout the period, the general government deficit ratio in both headline and structural terms is lower than the government investment-to-GDP ratio. Overall, general government investment, as a share of GDP, is among the highest in the euro area.

Finland's general government sector has recorded primary deficits since 2012 and is expected to remain in primary deficit also over 2016- 2017. The effective interest rate paid on debt has decreased significantly in recent years. Interest expenditure, as a share of GDP, is forecast by both the Commission as well as by the national authorities to fall over the forecast horizon. Finland's public finances, however, do not benefit from the decline in interest rates as public sector assets (at the end of 2015, employment pension schemes managed assets that amounted to 85% of GDP, total assets of the general government amounted to ca 130% of GDP based on the national accounts data) have been partially invested in interest-bearing assets. The loss of interest revenue there more than offsets the gain from the reduced interest expenditure on government debt.

Current expenditure excluding interest has been on an increasing trend. In fact, it increased by 9 pps. of GDP since 2005. It should be noted that 6.5 pps. of the change occurred in 2009, when nominal GDP contracted by 6.5%. At 58.3% of GDP, the level was the highest in the EU in 2015 Expenditure has increased in all sub-sectors of the general government over the years 2004 to 2014, but the increase has been proportionally highest in the earnings-related pension funds sector. When considering general government expenditure by function, it appears that expenditure growth is mainly driven by healthcare and pension expenditure, reflecting the ageing of society. Expenditure has also increased for general public services, despite the fact that expenditure related to public debt transactions (i.e. interest expenditure), which is taken into account under this category, has fallen as a share of GDP.

4.3. Medium-term government debt position

Long-term sustainability of public finances

The general government gross consolidated debt-to-GDP ratio stood at 63.1% of GDP in 2015. Based on medium-term projections building on the Commission's spring 2016 forecast, the debt is expected to rise to close to 76% of GDP by 2026 (based on the no-policy-change scenario, under the assumption that the structural primary balance position evolves according to the Commission's spring 2016 forecast until 2017), remaining above the 60%-of-GDP Treaty threshold. The increase would be mostly driven by the costs of ageing. Based on the Stability Programme scenario, which assumes that the budgetary plans in the programme are fully implemented, the debt-to-GDP ratio would increase more slowly, reaching ca 72% by 2026.

Finland is assessed to be at low risk of fiscal stress in the short term, but is at high sustainability risk in the medium term and medium risk in the long term due to the budgetary impact of the cost of ageing. The focus, therefore, should be on containing age-related expenditure growth further so as to contribute to the sustainability of public finances in the medium and long run. The impact of the latest pension reform, legislated in autumn 2015, will be included in the assessment once the Economic Policy Committee has conducted its peer review, following Finland's request.

Stock-flow adjustment

The stock-flow adjustment has a large impact on general government debt developments in Finland. This i.a. reflects the general government's high net-financial-assets position, at 50.7% of GDP in 2015, down from 54.0% of GDP in 2014[5]. The OECD projects net assets to amount to 47.0% of GDP by the end of 2016. Among OECD countries, this is one of the highest positive net financial asset positions. The stock-flow adjustments routinely occur as the earnings-related pension system, included in the general government sector, is partially pre-funded and is in surplus. The surplus is included in the general government balance but is not used to pay off general government debt. These funds are accounted for as net accumulation of assets in the stock-flow adjustment.

In 2012, the stock-flow adjustment accounted for 70% of the increase in the debt-to-GDP ratio. Thereafter, in 2013 - 2014, the adjustment accounted for roughly 30% of the change in the debt ratio. In 2015, the impact of the stock-flow adjustment was again higher, amounting to 40% of the change in debt-to-GDP ratio. This was caused by employment pension schemes selling the majority of their holdings of central government bonds, thereby reducing the amount of intra-government debt that is taken into account in the general government debt consolidation process from 2.6 billion euros in 2014 euros to 1 billion euros in 2015. Such sale was economically reasonable as the market value of Finland's debt is higher than the nominal value. The funds' investment decisions are independent from the central government, although the funds are under the regulatory oversight by the government. The funds are not mandated to have holdings of Finnish government debt. Therefore, the sale of government bonds owned by the pension funds could continue further, increasing the gross consolidated debt-to-GDP ratio. Due to the independent nature of the investment decisions, it is complicated to forecast the sale or acquisition of central government debt by the pension funds. However, the forecast for 2016 assumes that the impact of the stock-flow adjustment will be lower than in 2015. In 2016, the Stability Programme projects the pension funds' surplus to stand at 1.1% of GDP.

Total stock of debt guaranteed by the government

Finland had central government guarantees amounting to 21.5% of GDP in 2015, up from 17.4% of GDP in 2014. This ratio is high in comparison to other European countries. Guarantees linked to the financial sector amounted to 1.9% of GDP in 2015. At the end of 2015, a total of 41% of the stock of central government guarantees consisted of guarantees to enterprises (excl. housing corporations). These are issued to a wide group of non-financial corporations, mainly through the Finnvera corporation - a specialised state-owned financing company promoting export and growth of enterprises. Guarantees granted to housing corporations account for 23% and those to the rest of the world for 15% of the stock of guarantees. The remaining 21% is divided between households (mainly student loans), financial and insurance corporations and general government. The losses linked to the guarantees have been low until now.

Impact of the cycle

Finland has experienced bad economic times over 2012-13, and a large negative output gap, estimated at -2.9 % of GDP in 2014, has opened. The debt-to-GDP ratio is thus strongly influenced by cyclical developments. When corrected for the effects of the cycle, the

[5] OECD Economic Outlook no 98, Annex Table 33.

Commission forecast for general government debt is estimated to have stood at 58.5% of GDP in 2015, but to be above the reference value in 2016 (61.8% of GDP).

4.4. Other factors considered relevant by the Commission

Financial stabilisation operations

Among the other factors considered relevant by the Commission, particular consideration is given to financial contributions to fostering international solidarity and achieving the policy goals of the Union, the debt incurred in the form of bilateral and multilateral support between Member States in the context of safeguarding financial stability and the debt related to financial-stabilisation operations during major financial disturbances (Article 2(3) of Regulation (EC) No 1467/97).

In assessing compliance with the debt criterion, financial assistance to euro-area Member States with a debt-increasing impact has been taken into account. According to the Commission 2016 spring forecast, the cumulative impact of this assistance would amount to 2.8% of GDP in 2015. Thus, Finland's general government gross debt would have been at 60.3% of GDP in 2015 and would be at 63.9% in 2016 if the debt related to financial-stabilisation operations was deducted.

4.5. Other factors put forward by the Member State

On 9 April 2016, the Finnish authorities transmitted a letter with relevant factors pursuant to Article 2(3) of Regulation (EC) No 1467/97. The authorities emphasised the impact of the cycle on general government debt, compliance with the obligations under the preventive arm of the SGP, the government's commitment to the fiscal consolidation target set in the government programme, and the growth-enhancing structural reforms that are currently being prepared. In addition, Finland put forward the impact of the immigration-related expenditure, analysed the impact of low inflation environment on public revenues and expenditures and also concluded that the negative net impact from the low interest rate environment on the general government balance could amount to 0.3% of GDP in 2015 due to the lower revenues from the interest-bearing assets, mostly owned by the employment pension schemes.

The factors put forward by the Finnish authorities have been taken into account in the present report. The impact of the cycle has been analysed in Section 4.1 and compliance with the obligations under the preventive arm is assessed in Section 4.2. In assessing the compliance with the preventive arm, the low-inflation environment, impact of the low interest rate environment and the immigration-related expenditure are also taken into account. Structural reforms are considered in Section 4.1.

5. CONCLUSIONS

The general government gross debt increased to 63.1% of GDP in 2015, above the Treaty reference value. The 2016 Stability Programme envisages it to reach 65.0% of GDP in 2016 and 66.7% of GDP in 2017. Similarly, the Commission 2016 spring forecast projects gross debt above the reference value, at 65.2% of GDP in 2016 and 66.9% in 2017. In 2015, the breach of the debt criterion was no longer fully explained by Finland's financial support to safeguard the financial stability in the euro area, but the debt-to-GDP ratio would have been at 60.3%, narrowly over the Treaty reference value. The debt-to-GDP ratio increased strongly in 2015 due to the stock-flow adjustments, as the social security funds, part of general government, were liquidating some of their holdings of the central government securities. The social security funds have accumulated assets in parallel to the increase of the central and local government debt and these assets far outweigh the debt, resulting in positive net asset position of the general government. Additionally, it should be noted that the debt ratio reflects the effects of Finland's current cyclical position. Debt corrected for the effects of the cycle would have remained below 60% of GDP in 2015, but would be above the reference value in 2016.

This report also examined other relevant factors, notably finding that Finland is expected to broadly comply with the recommended adjustment path towards the MTO in 2016, which should help ensure – in the medium term – that debt decreases at a sufficient pace.

On this basis, the analysis presented in this report suggests that the debt criterion as defined in the Treaty and in Regulation (EC) No 1467/97 should be considered as currently complied with. However, as Finland's debt-to-GDP ratio has been on an increasing trend, and it is forecast to continue rising over the medium term under a no-policy-change assumption, the structural reforms increasing productivity and supply of labour are key to enhance Finland's growth prospects in the medium term. Their swift adoption and implementation would contribute to address the country-specific recommendations and improve fiscal sustainability.