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COMMISSION STAFF WORKING DOCUMENT

Analysis of the draft budgetary plan of FINLAND

Accompanying the document

COMMISSION OPINION

on the draft budgetary plan of FINLAND

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1. INTRODUCTION

Finland has submitted its Draft Budgetary Plan (DBP) for 2015 on 2 October 2014 in compliance with Regulation (EU) No 473/2013 of the Two-Pack. Finland is subject to the preventive arm of the Pact and should preserve a sound fiscal position which ensures compliance with the medium-term objective (MTO).

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission Forecast. Section 3 presents the recent and planned fiscal developments, according to the Draft Budgetary Plan, including an analysis of risks to their achievement based on the Commission Forecast. In particular, it also includes an assessment of the measures underpinning the Draft Budgetary Plan. Section 4 assesses the recent and planned fiscal developments in 2014-15 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. Section 5 provides an analysis of implementation of fiscal-structural reforms in response to the latest country-specific recommendations adopted by the Council on 8 July 2014. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

2013 was the second year of economic decline in Finland, as GDP decreased by 1.2%. While the Stability Programme and the Commission spring forecast saw positive developments for both 2014 and 2015, the outlook has deteriorated in the meantime. According to the Draft Budgetary Plan, the Finnish economy will stay flat in 2014 and grow by 1.2% in 2015. In the Stability Programme, it was forecast that the economy would grow by 0.5% in 2014 and by 1.4% in 2015. For 2014, exports of goods and services have been revised downwards significantly in the Draft Budgetary Plan, as was gross fixed capital formation. For 2015, the Draft Budgetary Plan maintains largely the projections of the Stability Programme, slightly revising gross fixed capital formation downwards.

The Commission Autumn forecast is less optimistic for 2014 and 2015. It points to a 0.4% decline in real GDP in 2014. Following a further contraction of real GDP in the first half of 2014, high frequency indicators indicate slow if not negative growth in the second half. Confidence indicators have declined sharply and the monthly output indicator published by Statistics Finland has been declining in both July and August. For 2015, the Commission forecasts 0.6% growth. Growth is expected to be weaker than projected in the Draft Budgetary Plan across all demand components, but especially in investments and exports. Nevertheless, due to lower imports the growth contribution of net exports is forecast to be similar as in the national forecast. The Commission also projects a slightly higher unemployment rate. The inflation forecast, a 1.3% HICP growth, is very similar to the national forecast.

Table 1. Comparison of macroeconomic developments and forecasts

	2013	2014			2015		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	-1.2	0.5	0.0	-0.4	1.4	1.2	0.6
Private consumption (% change)	-0.7	0.0	0.0	-0.2	0.3	0.3	0.2
Gross fixed capital formation (% change)	-4.8	-3.1	-3.6	-3.0	3.6	2.4	0.9
Exports of goods and services (% change)	-1.7	3.5	0.4	0.2	4.1	4.0	1.9
Imports of goods and services (% change)	-2.5	2.1	-0.9	-0.1	3.3	3.2	1.1
Contributions to real GDP growth:							
- Final domestic demand	-1.1	-0.5	-0.7	-0.7	0.9	0.8	0.3
- Change in inventories	0.0	0.4	0.3	0.1	0.1	0.1	0.0
- Net exports	0.3	0.6	0.5	0.1	0.3	0.3	0.3
Output gap[1]	-2.8	-2.6	-3.0	-3.1	-1.7	-2.2	-2.7
Employment (% change)	-1.5	-0.3	-0.4	-0.6	0.4	0.3	0.2
Unemployment rate (%)	8.2	8.4	8.6	8.6	8.3	8.5	8.5
Labour productivity (% change)	0.3	0.8	0.4	0.1	1.0	0.9	0.4
HICP inflation (%)	2.2	2.2	1.3	1.2	1.8	1.3	1.3
GDP deflator (% change)	2.4	1.6	1.3	1.4	1.4	1.4	1.4
Comp. of employees (per head, % change)	2.0	1.6	1.3	1.6	1.4	1.4	1.5
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-1.9	-0.3	-1.4	-1.9	-0.1	-1.1	-1.6

Note:

[1]In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source :

Stability programme 2014 (SP); Draft Budgetary Plan 2015 (DBP); Commission 2014 autumn forecast (COM); Commission calculations.

Box 1: The macro economic forecast underpinning the budget in Finland

The macroeconomic forecast underpinning the budget has been prepared by the Economics department of the Ministry of Finance. The management of the Economics department is separated from the Budget department, but so far no special legal provisions have been enacted to further secure its independence. The forecast is not endorsed by any other third party.

The independent body in charge of monitoring the application of the structural balanced-budget rule is the National Audit Office, but this body has no role in the production or endorsement of the macroeconomic forecasts.

Under Article 1(a) of Regulation (EU) No 473/2013: ‘independent bodies' means bodies that are structurally independent or bodies endowed with functional autonomy vis-à-vis the budgetary authorities of the Member State, and which are underpinned by national legal provisions ensuring a high degree of functional autonomy and accountability, including:

(i) a statutory regime grounded in national laws, regulations or binding administrative provisions; (ii) not taking instructions from the budgetary authorities of the Member State concerned or from any other public or private body; (iii) the capacity to communicate publicly in a timely manner; (iv) procedures for nominating members on the basis of their experience and competence; and (v) adequate resources and appropriate access to information to carry out their mandate. The Draft Budgetary Plan does not contain relevant information to assess the independence of the Economics department based on these criteria. Therefore, the Commission withholds its assessment on their independence due to insufficient information.

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The Draft Budgetary Plan forecasts the nominal deficit at 2.7% of GDP in 2014, up from 2.0% in the Stability Programme. Half of the increase can be explained by the switch to ESA2010[1], while the rest is explained by lower GDP and consequently lower revenues.

For 2015 the difference in the general government balance is markedly wider between the Draft Budgetary Plan and the Stability Programme. In the Stability Programme it was forecast that the deficit would decline to 1.2% of GDP in 2015, but under the Draft Budgetary Plan the deficit declines to only 2.4%. The difference is mostly explained by revenue developments, which are now projected to grow by less than the standard elasticity would suggest. Expenditure, as a share of GDP, is maintained at nearly the same level as forecast in the Stability Programme, with lower current expenditure being compensated by higher capital expenditure.

According to the Commission autumn forecast, the deficit is expected to reach 2.9% of GDP in 2014 before declining to 2.6% in 2015. The difference with the projections in the Draft Budgetary Plan in both years stems from different growth forecasts. The Commission 2014 autumn forecast has a somewhat more positive revenue projection compared to the DBP (revenue elasticity is higher). It also has a higher expenditure forecast however: the Commission forecast includes higher compensation for employees than the national forecast, but lower intermediate consumption.

[1] In comparing deficit developments, the switch to ESA 2010 accounting should be kept in mind. The deficit figures in the Stability Programme are not directly comparable to the Draft Budgetary Plan forecast. The difference stems from the accounting of the revenues associated with swap agreements, which were deducted from the interest payments under ESA95. Therefore, the previously used “EDP deficits” were 0.3 to 0.4pp lower than the general government net lending under ESA95. ESA 2010 removes this difference.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2013	2014			2015			Change: 2013-2015
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**55.4**	**56.4**	***55.8***	**56.0**	**56.8**	***55.8***	**56.3**	**0.4**
of which:								
- Taxes on production and imports	14.5	15.1	*14.7*	14.7	15.2	*14.7*	14.7	0.2
- Current taxes on income, wealth, etc.	16.4	16.7	*16.4*	16.4	16.8	*16.3*	16.6	-0.1
- Capital taxes	0.3	0.3	*0.2*	0.3	0.3	*0.3*	0.3	0.0
- Social contributions	12.9	13.6	*13.1*	13.1	13.6	*13.1*	13.2	0.2
- Other (residual)	11.4	10.7	*11.4*	11.5	10.9	*11.4*	11.5	0.0
Expenditure	**57.8**	**58.4**	**58.2**	**58.9**	**57.9**	**58.2**	**58.9**	**0.4**
of which:								
- Primary expenditure	56.6	57.4	56.9	57.6	56.8	56.9	57.6	0.3
of which:								
Compensation of employees	14.5	14.4	14.3	14.5	14.1	14.0	14.4	-0.5
Intermediate consumption	11.5	12.3	11.7	11.7	12.3	11.8	11.6	0.3
Social payments	21.8	23.1	22.6	22.7	23.0	22.6	22.9	0.8
Subsidies	1.3	1.4	1.4	1.4	1.4	1.3	1.4	0.0
Gross fixed capital formation	4.2	2.8	4.1	4.2	2.7	4.0	4.2	-0.2
Other (residual)	3.3	3.4	2.8	3.2	3.3	3.2	3.1	-0.1
- Interest expenditure	1.3	1.0	1.3	1.3	1.1	1.3	1.3	0.0
General government balance (GGB)	**-2.4**	**-2.0**	**-2.7**	**-2.9**	**-1.1**	**-2.4**	**-2.6**	**0.0**
Primary balance	**-1.2**	**-1.0**	**-1.4**	**-1.6**	**0.0**	**-1.1**	**-1.4**	**0.1**
One-off and other temporary	-0.1	0.1	0.0	0.0	0.1	0.0	0.0	0.1
GGB excl. one-offs	**-2.3**	**-2.1**	**-2.7**	**-2.9**	**-1.2**	**-2.4**	**-2.6**	**-0.1**
Output gap[1]	-2.8	-2.6	-3.0	-3.1	-1.7	-2.2	-2.7	0.9
Cyclically-adjusted balance[1]	-0.8	-0.6	-1.0	-1.1	-0.2	-1.2	-1.1	-0.5
Structural balance (SB)[2]	**-0.7**	**-0.7**	**-1.0**	**-1.1**	**-0.3**	**-1.2**	**-1.1**	**-0.6**
Structural primary balance[2]	0.5	0.3	0.0	0.2	0.8	-0.2	0.2	-0.9

Notes:

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

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

Source :

Stability programme 2014 (SP); Draft Budgetary Plan 2015 (DBP); Commission 2014 autumn forecast (COM); Commission calculations.

3.2. Debt developments

Finland's debt reached 56% of GDP by the end of 2013. It is forecast in the Draft Budgetary Plan that the debt ratio will reach close to 60% in 2014 and increase by a further 1.6 % of GDP, to more than 61% of GDP, in 2015. In the Stability Programme, the debt ratio was planned to increase by 1.3 % of GDP. The switch to ESA 2010 accounting did not have a significant influence on the debt level; although nominal GDP increased, nominal public debt also increased, as new bodies with debt were integrated into the general government. The debt ratio decreased by around 1% of GDP due to the new methodology.

For Finland, the stock-flow adjustment has an important effect on the changes in general government debt. This is driven by the fact that the earnings-related pension system within 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. Thus, this surplus shows up as net accumulation of financial assets under stock-flow adjustments. According to the statistical annex of the OECD Economic Outlook (September 2014), Finland's general government net financial assets will amount to 54.2% of GDP in 2015. Among OECD countries, only Norway has higher net assets while most countries have large liabilities.

Finland's debt includes the debt incurred for the financial contributions to fostering international solidarity and achieving the policy goals of the Union. According to the Commission 2014 autumn forecast, the cumulative impact of these contributions would amount to 3% of GDP in 2015. Thus, Finland's general government gross debt would be 58.8% of GDP in 2015 if debt related to financial stabilisation operations was removed from the total.

Risks to the projected gross debt ratio mainly stem from the macroeconomic forecast. Risks related to contingent liabilities, guarantees, financial rescue operations and debt assumptions seem contained.

Table 3. Debt developments

(% of GDP)	2013	2014			2015		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**56.0**	**59.8**	**59.6**	**59.8**	**61.0**	**61.2**	**61.7**
Change in the ratio	2.9	2.8	3.6	3.8	1.2	1.6	1.9
Contributions[2]:							
1. Primary balance	**1.2**	**1.0**	**1.4**	**1.6**	**0.0**	**1.1**	**1.4**
2. "Snow-ball" effect	**0.7**	**-0.2**	**0.6**	**0.7**	**-0.5**	**-0.2**	**0.1**
Of which:							
Interest expenditure	1.3	1.0	1.3	1.3	1.1	1.3	1.3
Growth effect	0.6	-0.3	0.0	0.2	-0.8	-0.7	-0.4
Inflation effect	-1.2	-0.9	-0.7	-0.8	-0.8	-0.8	-0.8
3. Stock-flow adjustment	**1.1**	**2.0**	**1.7**	**1.5**	**1.7**	**0.7**	**0.5**
Of which:							
Cash/accruals difference		0.0	n.a.		0.0	n.a.	
Net accumulation of financial		2.1	n.a.		2.2	n.a.	
of which privatisation proceeds		-0.2	n.a.		-0.3	n.a.	
Valuation effect & residual		-1.4	n.a.		-2.0	n.a.	

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual

Source :

Stability programme 2014 (SP); Draft Budgetary Plan 2015 (DBP); Commission 2014 autumn forecast (COM); Commission calculations.

3.3. Measures underpinning the draft budgetary plan

The Draft Budgetary Plan for 2015 includes most of the measures that were agreed in March 2014 as part of the central government expenditure ceiling negotiations. In addition to a long list of expenditure cuts affecting different central government agencies and programmes, the indirect tax rates were increased. Similarly, some direct taxes, such as the tax on gifts and inheritances, as well as the progressiveness of income taxation was increased.

Table 4. Main discretionary measures reported in the DBP

A. Discretionary measures taken by General Government - revenue side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2014	**2015**	**2016**
Taxes on production and imports	0.2	0.2	0.1
Current taxes on income, wealth,	-0.1	0.0	0.1
Capital taxes	n.a.	n.a.	n.a.
Social contributions	0.3	0.1	0.1
Property Income	n.a.	n.a.	n.a.
Other	n.a.	n.a.	n.a.
Total	0.4	0.3	0.3

Note:
The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that revenue increases as a consequence of this measure.
Source: Draft Budgetary Plan 2015

B. Discretionary measures taken by general Government- expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2014	**2015**	**2016**
Compensation of employees	n.a.	n.a.	n.a.
Intermediate consumption	-0.2	-0.9	-0.1
Social payments	n.a.	n.a.	n.a.
Interest Expenditure	n.a.	n.a.	n.a.
Subsidies	n.a.	n.a.	n.a.
Gross fixed capital formation	n.a.	n.a.	n.a.
Capital transfers	n.a.	n.a.	n.a.
Other	n.a.	n.a.	n.a.
Total	-0.2	-0.9	-0.1

Note:
The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure.
Source: Draft Budgetary Plan 2015

The measures agreed in March were included in the Stability Programme assessment and were taken into account when issuing the fiscal country-specific recommendation in July 2014. However, when the new government took office in July, some of the discretionary measures of the March package were repealed. Namely, the effective increase in the personal income tax (by not adjusting the income brackets for the application of progressive tax rates) was postponed to 2016. Furthermore, the reduction of child benefits was broadly offset by the introduction of a new system of tax deductions for parents. In September, the cancellation of the sugar tax increase was announced. The new government also cancelled the "windfall tax" meant for the electricity generators benefiting from emission trading.

As a result, the amount of discretionary revenue measures for 2015 was reduced from 0.6% of GDP in the Stability Programme to 0.3% of GDP in the DBP. Overall, the discretionary consolidation measures in the 2015 Draft Budgetary Plan amount to about 1.2% of GDP.

The Draft Budgetary Plan does not include one-off measures for 2015.

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

Box 2. Council recommendations addressed to Finland

On 8 July 2014, the Council addressed recommendations to Finland in the context of the European Semester. In particular, in the area of public finances the Council recommended Finland to limit the emerging gap relative to the medium-term objective, ensure to return to it in 2015 and respect it thereafter as planned. Finland was also recommended to ensure that the debt criterion is fulfilled, while pursuing a growth-friendly fiscal policy, as well as to implement rapidly the reforms set out in the structural policy programme and government spending limits and fiscal plan for 2015-2018 in order to reduce the fiscal sustainability gap and strengthen conditions for growth.

Other recommendations concerning fiscal-structural issues included the recommendation to ensure effective implementation of the ongoing administrative reforms concerning municipal structure, social and healthcare services and to increase the effective retirement age by aligning the retirement age or pension benefits to changes in life expectancy.

4.1. Compliance with the MTO

Based on the Draft Budgetary Plan data, Finland's structural balance as recalculated[2] is -0.6% of GDP in 2013, sufficiently close to Finland's medium-term budgetary objective (MTO) of a structural deficit of 0.5% of GDP. In 2014, the structural balance is estimated to deteriorate to -1.0% of GDP and in 2015 it is expected to decline further to -1.2% of GDP. Thus, in 2014 Finland moves away from its MTO and no correction is planned for 2015.

As Finland started the year 2014 at its MTO, no adjustment would have been required in 2014. As the structural balance is set to worsen, Finland would deviate from the required adjustment under the structural balance pillar by close to 0.5% of GDP, according to both the 2015 Draft Budgetary plan and the autumn forecast. In contrast, the expenditure benchmark is met with a positive margin of 0.5%, both in the Draft Budgetary Plan projections and the Commission forecast. The difference between the signals of the two pillars is mainly explained by the difference in the growth benchmarks used, although the high margin in meeting the expenditure benchmark implies that it would also have been met at lower growth rate.

In 2014, the expenditure benchmark would allow for expenditure (net of discretionary revenue measures) to grow by 0.8% of GDP, which is the current medium-term growth rate used for calculating the expenditure benchmark. The rate of potential output growth used in the calculation of the structural balance is much lower, 0% based on the recalculated Draft Budgetary Plan data and -0.2% based on the Commission autumn forecast data. Since the

[2] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission services on the basis of the information provided in the Draft Budgetary Plan, using the commonly agreed methodology.

annual rate of potential output growth has remained well below 0.8% since 2009 and is expected to remain low over the forecast horizon, it appears to provide a more reliable basis for assessing fiscal policy than the higher medium-term growth rate. Consequently, the structural balance pillar appears most relevant in 2014 and the overall assessment, based on both the Draft Budgetary Plan and the Commission forecast, concludes that there is a risk of some deviation from the adjustment path towards the MTO.

The deviation is very close to the limit of significance in 2014. In terms of the quality of the fiscal adjustment, it should be noted that part of the deterioration in the structural balance stems from Finland's decision to reduce the corporate income tax rate from 24.5% to 20% as from the beginning of 2014. While this reduces the revenues for 2014, there is an expected medium-term benefit in terms of increased incentives to investment. Boosting investment is a pre-requisite to the needed restructuring of the Finnish economy, as indicated in the Council's country-specific recommendations in 2013 and 2014.

With Finland not being at its medium-term objective in the beginning of **2015** and taking into account that a large negative output gap indicates difficult economic times, the required adjustment for 2015 would be limited to 0.1% of GDP. In contrast to this requirement, the Draft Budgetary Plan foresees that the structural balance worsens further in 2015 compared to 2014, by 0.2% of GDP. This constitutes a 0.3% of GDP deviation from the required adjustment. While this deviation is not regarded as significant over 1 year, the deviation cumulated over 2014 and 2015 becomes significant in 2015, at 0.4% of GDP (exceeding the 0.25% threshold of significance). According to the Commission forecast, the deviation would be more limited, at 0.1% of GDP in 2015, but the average deviation over two years would still exceed the limit of significance.

According to the information provided in the Draft Budgetary Plan, the growth rate of government expenditure, net of discretionary revenue measures, is expected to contribute to an annual structural adjustment in 2015, because the growth rate of this expenditure is below 0.6%, the lower rate under the expenditure benchmark (calibrated according to the required adjustment towards the MTO). Thus, the expenditure benchmark is comfortably met in 2015. The Commission forecast reaches the same conclusion, indicating that the expenditure benchmark is exceeded by 0.4% in 2015 and on average by 0.3% over 2014-15.

As the change in the structural balance and the expenditure benchmark point again in different directions in 2015, an overall assessment is required.

According to the autumn forecast, the main explanatory factor regarding the difference in the two pillars, over the two years, continues to be the difference in the growth rates used under the two pillars. The annual potential GDP growth rate used for the computation of the structural balance is lower than the higher rate of expenditure growth in the expenditure benchmark, when the convergence margin is calibrated according to the required adjustment (expenditure benchmark would allow the expenditure to grow by 0.6% in 2015).

Table 5. Compliance with the requirements of the preventive arm of the Stability and Growth Pact

(% of GDP)	2013	2014		2015	
Initial position[1]					
Medium-term objective (MTO)	-0.5	-0.5		-0.5	
Structural balance[2] (COM)	-0.7	-1.1		-1.1	
Structural balance based on freezing (COM)	-0.6	-0.9		-	
Position vis-a -vis the MTO[3]	At or above the MTO	At or above the MTO		Not at MTO	
(% of GDP)	**2013**	**2014**		**2015**	
	COM	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.0	0.0		0.1	
Change in structural balance[5]	0.4	-0.4	-0.4	-0.2	0.0
One-year deviation from the required adjustment after considering the relevant factors[6]	1.3	-0.5	-0.5	-0.3	-0.1
Two-year average change in structural balance[5]	0.0	0.0	0.0	-0.3	-0.2
Two-year average deviation from the required adjustment after considering the relevant factors[6]	1.1	0.4	0.4	-0.4	-0.3
Expenditure benchmark pillar					
Applicable reference rate[7]	1.4	0.8		0.6	
One-year deviation[8]	0.8	0.5	0.3	0.1	0.4
Two-year average deviation[8]	0.6	0.6	0.5	0.3	0.4
Conclusion					
Conclusion over one year	Compliance	Overall assessment	Overall assessment	Overall assessment	Overall assessment
Conclusion over two years	Compliance	Compliance	Compliance	Overall assessment	Overall assessment

Notes

[1] 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.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] 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.).

[5] 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.

[6] 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.

[7] 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 lower 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.

[8] 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.

Source :

Draft Budgetary Plan 2015 (DBP), Commission 2014 autumn forecast (COM), Commission calculations

Nevertheless, according to the Commission Forecast, the transgression of the threshold for significance is very small.

In addition, it must be noted that the change to ESA 2010 leads to a level shift in both the nominal deficit and the structural balance. Continued use of ESA95 would likely have resulted in a 0.1% of GDP lower required adjustment in 2015. This is because, while under ESA95, monetary flows related to swap and forward rate agreements entered as interest revenues in the EDP deficit reporting, these flows are treated as financial transactions related to derivatives under ESA 2010. Thus, according to the Commission's calculations, Finland's deficit in 2014 would have been 0.35% of GDP lower under ESA95 accounting method, since the above-mentioned flows would have a deficit-decreasing impact. Adjusting the structural balance by the same amount, Finland would have been found to be sufficiently close to the MTO in the beginning of 2015 and therefore no adjustment would have been required. Therefore, a 0.05% of GDP of the average deviation in the structural balance pillar could be regarded as statistically driven. If this is taken into account, the deviation over two years would not be significant according to the Commission forecast.

In the Draft Budgetary Plan Finland has requested a temporary deviation from the adjustment path towards the MTO on account of major structural reforms with direct long-term positive budgetary effects. Calculations have been provided regarding the expected savings from the pension reform. However, most of the reforms mentioned in the Draft Budgetary Plan are not yet legislated. This also applies to the pension reform, even if already agreed by the social partners, the aim is to enact the reform in 2017 and the parliament to be elected in April 2015 will be called to approve it. Furthermore, there is no indication that part of the current spending is linked to the up-front cost of the reforms. Thus, the structural reform clause cannot be granted.

Following an overall assessment of the Member State’s Draft Budgetary Plan, with the structural balance as a reference, including an analysis of expenditure net of discretionary revenue measures, the adjustment path towards the MTO appears to deviate from the requirements, but the deviation is not expected to be significant.

On the basis of this assessment, it appears that Finland is not expected to comply with the relevant part of the fiscal country-specific recommendation addressed to it by the Council on 8 July 2014.

5. IMPLEMENTATION OF FISCAL-STRUCTURAL REFORMS

As part of the fiscal CSR, Finland received a recommendation to implement rapidly the reforms set out in the structural policy programme and government spending limits and fiscal plan for 2015-2018 in order to reduce the fiscal sustainability gap and strengthen conditions for growth.

In 2013, Finland adopted a broad structural policy programme for improving growth conditions and reducing the sustainability gap[3]. The government is foreseeing measures to balance local government finances, to increase the efficiency of the public sector, to extend working careers by 2 years and to improve competition and competitiveness. More specific steps have been announced in the context of the latest expenditure ceilings decision in March

[3] A structural policy programme to strengthen conditions for economic growth and bridge the sustainability gap in general government finances is available at: http://valtioneuvosto.fi/etusivu/rakenneuudistus395285/tiedostot/rakennepoliittinen-ohjelma-29082013/fi.pdf

2014[4] and in the National Reform Programme 2014[5]. Further implementing decisions were taken in August 2014[6].

The assessment of the reforms undertaken by the Finnish authorities in response to the recommendations issued by the Council in July 2014 in the context of the EU Semester is generally positive. Comprehensive reforms of the municipal structure, healthcare and social services are being prepared, the youth guarantee has been extended, early exit pathways from the labour market are being reduced, the national competition authority has been strenghtened. Finland reformed the corporate income tax system from 2014, reducing the corporate income tax rate and increasing dividend taxation. The aim is to increase the growth-friendliness of the tax system.

A pension reform has been agreed by the social partners in late September 2014. The reform links pension age to life expectancy as recommended by the Commission in the proposal for Country-Specific Recommendations in 2014. The target is to implement the reform from 2017 onwards. According to the national authorities, the reform will improve fiscal sustainability by approximately 1.1% of GDP.

Political parties have reached a consensus regarding the direction of the healthcare and social care reforms. All social welfare and healthcare services are to be delivered by five regional providers, based on current, specific catchment areas. The legislative proposal is under discussion and it is expected that the new structures will be effective by 2017. However, the details of the reform are not known.

The municipal reform is built on voluntary mergers of municipalities, which are currently preparing detailed studies on the benefits of the mergers. Municipalities that will take merger decisions within the deadline will be entitled to grants and compensation. However, the government has set in the structural policy programme targets to reduce the duties and obligations and to cut the overlapping activities in order to increase the efficiency. At the same time, the municipalities are expected to improve productivity and to increase tax revenues, thus closing the deficit (1% of GDP) currently persistent in the local government sector.

If forcefully implemented, these measures could have a strong positive impact on public finances in the medium term through increased growth and expenditure reduction.

[4] Hallituksen päätös rakennepoliittisen ohjelman toimeenpanosta osana julkisen talouden suunnitelmaa http://valtioneuvosto.fi/tiedostot/julkinen/kehysneuvottelut-2014/paatos/fi.pdf

[5] http://www.vm.fi/vm/en/04_publications_and_documents/01_publications/02_economic_surveys/20140415Europe/Europa_2020_Spring_2014_NETTI.pdf

[6] Government decision on strenghtening the implementation of the structural policy programme http://valtioneuvosto.fi/tiedostot/julkinen/pdf/2014/budjettineuvottelut-2014/rakennepoliittinen-ohjelma/government-decision-280814.pdf

6. OVERALL CONCLUSION

In 2014, the Commission 2014 autumn forecast, based on an overall assessment, points to some deviation from the adjustment path to the MTO in the case of Finland. The structural balance is expected to weaken further in 2015, causing the structural balance pillar to indicate a significant deviation from the required adjustment path over the period 2014-2015 taken together. Although the expenditure benchmark is met with a margin in 2015, the overall assessment concludes that there is a risk of some deviation from the required adjustment path towards the MTO in 2015. Gross debt in Finland is forecast to exceed 60% of GDP in 2015.

Finland has made some progress with regard to the fiscal-structural part of the recommendations addressed to it by the Council on 8 July 2014. In particular, the government has taken action to rapidly implement the reforms set out in the structural policy programme and government spending limits and fiscal plan for 2015-2018 in order to reduce the fiscal sustainability gap and strengthen conditions for growth. Their forceful implementation could result in a significant strengthening of Finland's fiscal position.