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Analysis of the 2016 Draft Budgetary Plan of FINLAND

Accompanying the document

COMMISSION OPINION

on the Draft Budgetary Plan of FINLAND

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1. INTRODUCTION

Finland submitted its Draft Budgetary Plan (DBP) for 2016 on 28 September 2015 in compliance with Regulation (EU) No 473/2013 of the Two-Pack. On 28 September 2015, Finland also submitted an updated Stability Programme. It incorporates the measures foreseen in the programme of the new government which took office since the submission of the no-policy-change April Stability Programme. Finland is subject to the preventive arm of the Pact and should ensure sufficient progress towards its medium-term budgetary objective (MTO).

Section 2 of this document presents the macroeconomic outlook underlying the DBP and provides an assessment based on the Commission 2015 autumn forecast. The following section presents the recent and planned fiscal developments, according to the DBP, including an analysis of risks to their achievement based on the Commission 2015 autumn forecast. In particular, it also includes an assessment of the measures underpinning the DBP. Section 4 assesses the recent and planned fiscal developments in 2015-16 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact (SGP). Section 5 provides an analysis of implementation of reforms in the area of fiscal governance in response to the latest Country-specific Recommendations (CSRs) adopted by the Council on 14 July 2015, including those to reduce the tax wedge. Section 6 provides a short description of the updated Stability Programme submitted together with the DBP. Section 7 concludes.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

2014 was the third consecutive year Finland experienced a decline in economic activity, as real GDP decreased by 0.4%. While the Stability Programme submitted in April 2015 and the Commission 2015 spring forecast saw accelerating growth for both 2015 and 2016, the outlook has somewhat deteriorated in the meantime. According to the DBP, the Finnish economy is expected to grow by 0.2% in 2015 and by 1.3% in 2016, somewhat lower than foreseen in the April Stability Programme. The Commission 2015 autumn forecast foresees a broadly similar growth outlook in 2015 (0.3% vs 0.2%), while for 2016 it is less optimistic than the national forecast, expecting a roughly ½ pp. smaller growth rate. According to the Commission 2015 autumn forecast, private consumption is expected to be weaker and the turnaround in investment activity is expected to be slower than in the DBP forecast. Therefore, the DBP forecast uses favourable real growth assumptions.

The Commission 2015 autumn forecast includes a higher increase in the GDP deflator for 2015, leading to a higher nominal GDP forecast for 2015, due to lower assumed import prices. Therefore, due to base effects, this leads to a higher nominal GDP in 2016 in the Commission 2015 autumn forecast compared to the DBP, despite the lower real growth forecast in 2016. Consequently, taking real and nominal developments together, the macroeconomic scenario underlying the DBP is plausible.

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. Finland is the only euro area Member State that has designated a Ministry of Finance department as the independent forecast producer referred to in the Two-pack. The management of the Economics department is separated from the Budget department and according to the law adopted in spring 2015, the Economics department is independent in its forecasting activities. The forecast is not endorsed by any other third party.

The independent body in charge of monitoring 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.

Table 1. Comparison of macroeconomic developments and forecasts

	2014	2015			2016		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	-0.4	0.5	0.2	0.3	1.4	1.3	0.7
Private consumption (% change)	0.5	0.5	1.0	0.7	0.8	0.8	0.5
Gross fixed capital formation (% change)	-3.3	-0.4	-1.3	-2.0	3.7	5.4	3.1
Exports of goods and services (% change)	-0.7	1.5	0.9	-0.1	3.0	3.0	2.3
Imports of goods and services (% change)	0.0	1.0	-0.2	-0.7	2.8	3.4	2.8
Contributions to real GDP growth:							
- Final domestic demand	-0.5	0.3	0.3	0.0	1.3	1.5	0.9
- Change in inventories	0.5	0.1	-0.5	0.1	0.0	0.0	0.0
- Net exports	-0.3	0.2	0.4	0.2	0.1	-0.2	-0.2
Output gap[1]	-2.9	-2.8	-2.6	-2.5	-1.7	-1.6	-2.0
Employment (% change)	-0.8	0.3	-0.7	-0.4	0.3	0.3	0.3
Unemployment rate (%)	8.7	8.8	9.6	9.6	8.6	9.4	9.5
Labour productivity (% change)	0.4	0.3	0.9	0.7	1.1	1.0	0.4
HICP inflation (%)	1.2	0.3	0.3	-0.2	1.3	1.3	0.6
GDP deflator (% change)	1.6	0.7	0.4	1.3	1.4	1.2	1.2
Comp. of employees (per head, % change)	1.4	1.2	1.2	1.2	1.3	1.2	1.3
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-2.1	-0.6	-1.4	-1.0	-0.5	-1.5	-1.0

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 2015 (SP); Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The DBP forecasts the headline deficit at 3.4% of GDP in 2015, unchanged from the April Stability Programme. The Commission 2015 autumn forecast predicts a slightly lower deficit of 3.2% of GDP in 2015. The difference is mainly linked to the expected higher nominal GDP in 2015 and to the more favourable tax elasticitities used by the Commission.

For 2016, the DBP predicts a smaller general government deficit than the April Stability Programme. In the April Stability Programme the deficit was forecast to remain at 3.2% of GDP in 2016, while the DBP expects the deficit to decline to 2.8%. The reason for the difference is that the April Stability Programme was based on a no-policy-change assumption whereas the DBP includes new policy measures announced by the new government taking office after the April 2015 elections. The Commission 2015 autumn forecast takes the measures announced fully into account and expects the deficit to decline to 2.7% in 2016, somewhat lower than the DBP on account of the higher nominal GDP forecast, lower base in 2015 but also due to more favourable tax elasticities.

Box 2: Impact of the current low interest rate environment on compliance with the SGP

Identifying an interest rate windfall/shortfall for 2016

Finland's general government issued debt instruments have enjoyed, since the financial crisis, the status of safe haven asset and the yield has been among the lowest levels in the EU. Sovereign bond yields have fallen sharply since end-2013 and reached historical lows in the first half of 2015, before increasing somewhat during the summer months. However, yields in Finland still remain well below their long-term averages (3.6%), with 10-year rates standing at 0.75% at early November 2015. As a result of lower interest rates and with the gradual refinancing of earlier debt issued at higher interest rates, total interest payments by the general government have also decreased over the last years. Interest expenditure in Finland is expected to fall from 1.4% of GDP in 2012 to 1.2% in 2015, and is projected to decrease further next year, to 1.1% of GDP in 2016, based on the information provided in the DBP. This is despite the debt-to-GDP ratio increasing from 52.9% in 2012 to 64.3% in 2016 (DBP forecast). The Commission forecast reaches similar conclusions regarding the development of interest expenditure.

On the other hand, the financial assets held by the general government, mainly statutory earnings-related pension funds, amounted to 128.6% of GDP in the end of 2014. Among these assets, bonds and loans account for 36.5% of GDP and shares for 77.8% of GDP. The Finnish pension funds have sought to invest into higher-yielding assets such as foreign government and corporate bonds or equity investments rather than investing in Finnish government bonds. Whereas the share prices have significantly increased, the dividend yields have declined together with the decline in bond interest rates. In times of generally declining interest rates, the property income of the general government has decreased by 0.3% of GDP between 2012 and 2014 despite the increase in asset stock – more than offsetting the lower interest expenditure gains.

Prospects and vulnerability

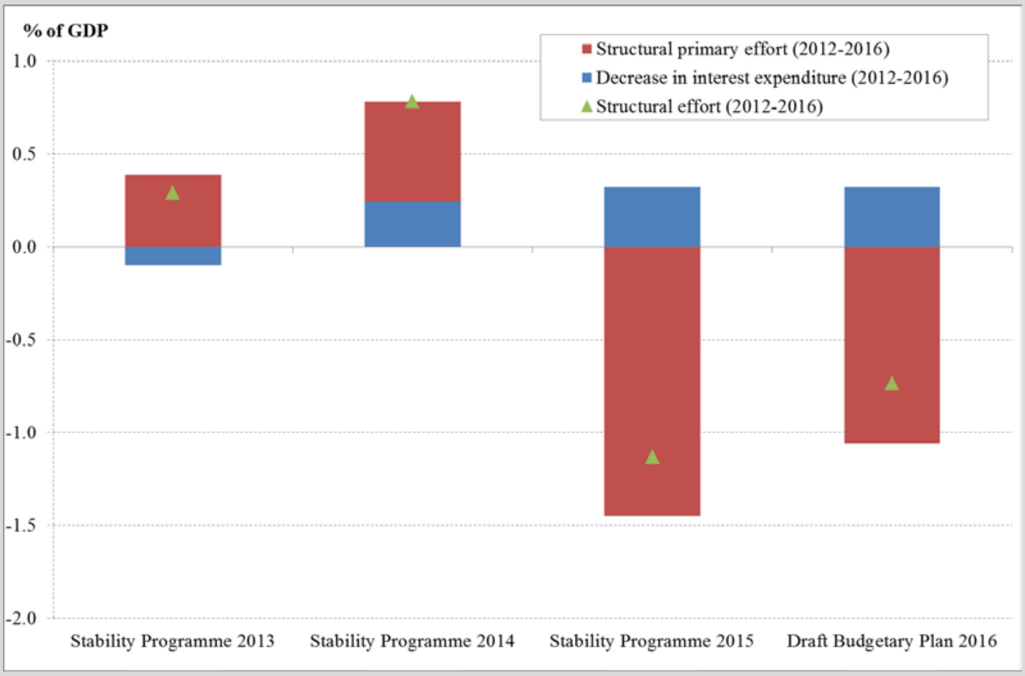
In 2015, the Treasury of Finland is planning to issue 16.9 bn euros of debt. Over 2016-18, ca 33.1 bn euros, or close to 15% of GDP, of outstanding debt has to be renewed. A 1 pp change in the interest rate would increase or decrease the interest expenditure by 0.15% of GDP. At the same time, the revenue from assets would be affected in the opposite direction.

Consequences for public finances

Comparing the interest expenditure projections across different vintages of Stability and Convergence Programmes and DBPs sheds more light on the (unexpected) interest windfall since the fall in interest rates (see Chart).[1]

Interest spending projections have not radically changed between the different vintages of the forecast since the 2014 Stability Programme as the expected decrease in interest expenditure has remained at 0.2-0.3% of GDP. If there have been positive surprises regarding the lowering of the interest rate, these have been offset by negative surprises in the primary deficit – therefore the higher than expected debt level and, as indicated above, the windfalls have been more than offset by the property income shortfalls.

Structural effort and decrease in interest expenditures between 2012 and 2016 based on government plans



Source: Stability programmes, Draft Budgetary Plan 2016 and AMECO

The low inflation environment has consequences on the development of government revenues. The impact on income taxes comes from the lower property income of households – therefore, the taxable income remains lower. Second round effects come from the reduced consumption of households and the resulting lower indirect tax collection.

After strong wage increases during the first crisis years, wage increases have remained low in the recent years, mainly thanks to the moderate wage agreements between the labour market partners. Due to the low inflation environment, the low nominal wage increases have resulted

[1] Note that, while it is likely that revisions in the interest expenditure projections across different vintages primarily reflect changes in interest rates, other factors such as debt dynamics, the maturity profile of debt and statistical reclassifications (e.g. the switchover to the ESA 2010 standard of national accounts) may also have played a role.

in only a minor correction of real wages, therefore delaying the improvement of competitiveness, the creation of new jobs and increased investments.

Indirect tax collection is most significantly influenced by the low inflation environment. This is most evident in 2015, where the initial budgetary plans were made assuming a significantly higher consumer price increase and therefore higher indirect tax collection. This is evident when comparing the results of structural balance adjustment and the expenditure benchmark, with the latter using the inflation rate "frozen" at the time of the 2015 budget preparation.

Overall, while the low interest rate environment had a small positive impact on the general government interest expenditure, there are also significant costs as Finland is a country with a large positive net asset position, both in the public and the private sector. The negative impact of the low interest environment on the income on government assets was larger than the deficit-reducing impact of lower government interest expenditure. In addition, the low interest rate and low inflation environment has a negative impact on tax revenues.

The DBP mentions some costs related to the integration of refugees over 2016-2019, but does not include a comprehensive estimate of all additional refugee-related costs in 2015 and 2016. Reflecting the partial information available at the time of the Commission forecast, a downside risk to the deficit projection is related to the inflow of asylum seekers, which could be higher than expected, as indicated in the letter sent by the Finnish authorities to the Commission on 3 November 2015 in the context of the Commission report under article 126(3) TFEU.

In structural terms, the DBP leads to a slight worsening of the recalculated structural balance[2] by 0.1% of GDP over 2014-16. The Commission 2015 autumn forecast assumes an improvement of the structural balance by 0.3% over 2014-16, on account of larger nominal GDP and larger output gap.

On 16 November 2015, the Commission issued a report under Article 126(3) TFEU, as the notified deficit for 2014 and the planned deficit for 2015 provide prima facie evidence of the existence of an excessive deficit in Finland, before analysing relevant factors. The analysis concluded that after considering the relevant factors, the deficit criterion should be considered as complied with.

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

Table 2. Composition of the budgetary adjustment

(% of GDP)	2014	2015			2016			Change: 2014-2016
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**54.9**	**55.6**	***55.5***	**54.9**	**55.5**	***55.4***	**55.4**	**0.5**
of which:								
- Taxes on production and imports	14.4	14.4	*14.4*	14.2	14.3	*14.3*	14.3	-0.1
- Current taxes on income, wealth, etc.	16.5	16.6	*16.8*	16.7	16.7	*16.5*	16.7	0.0
- Capital taxes	0.2	0.3	*0.3*	0.3	0.3	*0.3*	0.3	0.1
- Social contributions	12.8	13.1	*13.0*	12.8	13.0	*13.1*	13.1	0.3
- Other (residual)	11.0	11.2	*11.0*	10.8	11.2	*11.2*	11.0	0.2
Expenditure	**58.3**	**59.1**	**58.8**	**58.1**	**58.7**	**58.2**	**58.1**	**-0.1**
of which:								
- Primary expenditure	57.0	57.9	57.6	56.9	57.6	57.1	57.0	0.1
of which:								
Compensation of employees	14.2	14.2	14.1	14.1	13.9	13.9	14.0	-0.3
Intermediate consumption	11.6	12.0	11.8	11.6	12.0	11.9	11.7	0.3
Social payments	22.4	23.0	23.1	22.8	23.0	23.0	23.1	0.6
Subsidies	1.4	1.3	1.3	1.3	1.2	1.2	1.2	-0.2
Gross fixed capital formation	4.1	4.3	4.1	3.9	4.3	4.1	3.9	0.0
Other (residual)	3.3	3.1	3.2	3.2	3.2	3.0	3.0	-0.3
- Interest expenditure	1.2	1.2	1.2	1.2	1.1	1.1	1.1	-0.1
General government balance (GGB)	**-3.3**	**-3.4**	**-3.4**	**-3.2**	**-3.2**	**-2.8**	**-2.7**	**0.5**
Primary balance	**-2.1**	**-2.2**	**-2.2**	**-2.0**	**-2.0**	**-1.7**	**-1.5**	**0.4**
One-off and other temporary measures	0.1	0.0	0.0	0.0	0.0	0.0	0.0	-0.1
GGB excl. one-offs	**-3.4**	**-3.4**	**-3.4**	**-3.2**	**-3.2**	**-2.8**	**-2.7**	**0.6**
Output gap[1]	-2.9	-2.8	-2.6	-2.5	-1.7	-1.6	-2.0	1.2
Cyclically-adjusted balance[1]	-1.7	-1.8	-1.9	-1.7	-2.2	-1.9	-1.5	-0.2
Structural balance (SB)[2]	**-1.8**	**-1.8**	**-1.9**	**-1.7**	**-2.2**	**-1.9**	**-1.5**	**-0.1**
Structural primary balance[2]	-0.5	-0.6	-0.7	-0.6	-1.1	-0.8	-0.4	-0.2

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 2015 (SP); Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations

3.2. Debt developments

Finland's debt reached 59.3% of GDP in 2014. The DBP expects the debt ratio to reach 62.6% in 2015 and 64.3% in 2016, similar to the Commission 2015 autumn forecast.

Finland's debt has been increasing due to the relatively high primary deficits but also due to the "snowball effect".[3] Interest expenditure, although declining over the recent years, has not been offset by the positive effects arising from real economic growth and inflation. For Finland, also the stock-flow adjustment has an important effect on the changes in general government debt, as it is driven by the fact that the statutory earnings-related pension system within the general government sector is partially pre-funded and in surplus. The surplus is saved and shows up as net accumulation of financial assets under stock-flow adjustment. According to the statistical annex of the OECD Economic Outlook (September 2015), Finland's general government net financial assets are expected to amount to 51.0% of GDP in 2015. Among OECD countries, only Norway has higher net assets while most countries have large net liabilities.

Finland's debt includes the debt incurred while participating in the financial contributions to fostering international solidarity and achieving the policy goals of the Union. The cumulative impact amounts to 2.8% of GDP in 2015. Thus, Finland's general government gross debt would be 59.7% of GDP in 2015 if debt related to financial stabilisation operations was deducted from the total debt stock. The debt-to-GDP ratio is also influenced by the current cyclical position. When corrected for the effects of the cycle, the Commission's forecast for general government debt is 57.5% of GDP in 2015.

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

As mentioned in section 3.1, on 16 November 2015 the Commission issued a report under Article 126(3) TFEU which concluded, after considering the relevant factors, also that the debt criterion should be considered as complied with.

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[3] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation.

Table 3. Debt developments

(% of GDP)	2014	2015			2016		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**59.3**	**62.5**	**62.6**	**62.5**	**64.4**	**64.3**	**64.5**
Change in the ratio	3.8	3.2	3.3	3.2	1.9	1.7	2.0
Contributions[2] *:*							
1. Primary balance	**2.1**	**2.2**	**-2.2**	**2.0**	**2.0**	**-1.7**	**1.5**
2. "Snow-ball" effect	**0.6**	**0.4**	**5.2**	**0.2**	**-0.5**	**3.0**	**0.0**
Of which:							
Interest expenditure	1.2	1.2	5.6	1.2	1.2	4.5	1.1
Growth effect	0.2	-0.3	-0.1	-0.2	-0.9	-0.8	-0.4
Inflation effect	-0.9	-0.5	-0.2	-0.8	-0.9	-0.7	-0.7
3. Stock-flow adjustment	**1.1**	**0.5**	**0.2**	**1.0**	**0.5**	**0.4**	**0.5**
Of which:							
Cash/accruals difference		0.0	n.a.		0.0	n.a.	
Net accumulation of financial assets		1.2	n.a.		1.3	n.a.	
of which privatisation proceeds		n.a.	n.a.		n.a	n.a.	
Valuation effect & residual		-1.4	n.a.		-2.5	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 2015 (SP); Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations

3.3. Measures underpinning the Draft Budgetary Plan

In 2016, the decrease in the deficit is mainly due to discretionary fiscal measures, both on the revenue and expenditure-side. Expenditure cuts include freezing of index-increases to benefits (excluding social assistance) linked to the national pensions index and of the cost-of-living index. There are also expenditure cuts aimed at reducing the spending on development cooperation, education and training and subsidies to enterprises. On the revenue side, an increase in the unemployment insurance contributions as of 2016 is planned, with the view to reduce the deficit in social security funds by 0.3% of GDP.

Other tax measures included in the DBP and the Commission 2015 autumn forecast are aimed at increasing the growth-friendliness of taxation in a revenue neutral manner. Government revenue is reduced by a decision to carry out annual adjustments to rising earnings and inflation to the progressive earned income tax scale in 2016. According to the previous plans, no adjustment was foreseen for 2016. In addition, the revenue is reduced by increasing the tax credit for work income (earned income deduction) thus easing the taxation of lower incomes.

Also, the broadcasting company tax parameters are modified, so that the lowest income limit at which the tax is levied will rise to ca 10,300 euros (per year).

On the other hand, the government plans to accelerate the reduction of the deductibility of mortgage interest expenditure as of 2016. Furthermore, the highest income bracket in the central government tax scale is expected to remain in effect until 2019 and the limit where it applies from is reduced from 90000 to 72300 euros for 2016 and 2017. The tax rate for capital income exceeding 30,000 euros is foreseen to be raised from 33% to 34%. Indirect taxation is expected to be increased, as taxes on tobacco, waste and energy are raised.

Table 4. Main discretionary measures reported in the Draft Budgetary Plan

A. Discretionary measures taken by General Government - revenue side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2015	**2016**	**2017**
Taxes on production and imports	0,2	0,1	0,0
Current taxes on income, wealth, etc.	-0,1	-0,1	-0,1
Capital taxes	n.a.	n.a.	n.a.
Social contributions	0,2	0,3	0,1
Property Income	n.a.	n.a.	n.a.
Other	n.a.	n.a.	n.a.
Total	0,3	0,3	0

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 for 2016

B. Discretionary measures taken by general Government- expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2015	2016	2017
Compensation of employees	n.a.	n.a.	n.a.
Intermediate consumption	n.a.	n.a.	n.a.
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	-0,6	-0,4	-0,4
Total	-0,6	-0,6	-0,6

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 for 2016

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

Finland is subject to the preventive arm of the Pact and should ensure sufficient progress towards its MTO. Box 3 reports the latest country specific recommendations in the area of public finances.

Box 3. Council recommendations addressed to Finland

On 14 July 2015, 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 achieve a fiscal adjustment of at least 0.1% of GDP towards the MTO in 2015 and 0.5% of GDP in 2016, and to continue efforts to reduce the fiscal sustainability gap and strengthen conditions for growth.

4.1. Adjustment towards the MTO

The required adjustment for 2015 is 0.1% of GDP. Based on the DBP, the structural balance, (recalculated based on the DBP data) points to some deviation (0.2% of GDP) from the requirement. Over 2014 and 2015 taken together, the average adjustment based on the structural balance pillar falls short by 0.5%, therefore pointing to a significant deviation. By contrast, the growth rate of government expenditure, net of discretionary revenue measures, in 2015 will not exceed the applicable expenditure benchmark rate. The expenditure benchmark is expected to be met with the margin of 0.9% of GDP over one year and with a margin of 0.6% of GDP over 2014 and 2015 taken together. The difference between the two pillars is mainly explained by the difference in the potential growth benchmarks used and the effect of lower-than-expected inflation. The structural balance is based on a lower estimate of medium-term potential growth compared to the average underlying the expenditure benchmark, with the former being more adequate given the current low-growth macroeconomic environment. In turn, the expenditure benchmark better reflects the inflation expectations when the budget was prepared. On balance, the overall assessment points to a risk of some deviation from the required adjustment towards the MTO over 2014-15 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.

Based on the Commission 2015 autumn forecast, the structural balance is expected to remain unchanged in 2015, falling by 0.1% short of the recommended fiscal effort.[4] Over 2014 and 2015 taken together, the average deviation is 0.4% of GDP. The expenditure benchmark is met by a positive margin of 0.6% in 2015 and with the margin of 0.5% over 2014-15 taken together. On the one hand, the current estimate of potential GDP growth underlying the structural balance estimate is lower than the medium-term average used in the expenditure benchmark (frozen based on the Commission 2013 winter forecast). The former seems to provide a more adequate estimate of medium-term potential growth at the current juncture because the macroeconomic outlook in Finland has changed negatively compared to the one expected in 2013. The structural balance is also negatively affected by revenue shortfalls. On the other hand, the difference in potential growth benchmarks also captures the effects of lower-than-expected inflation. Whereas the expenditure benchmark uses the deflator from the relevant vintages of the forecast, the structural balance reflects actual inflation which turned out much lower than previously forecast, suggesting that in this respect the expenditure benchmark seems to be a better indicator of the fiscal effort at the current juncture. On balance, the overall assessment points to a risk of some deviation from the required adjustment towards the MTO over 2014-15 taken together, which will need to be reassessed ex post taking into consideration whether the economic situation in 2014 (i.e. negative real growth) justifies the observed loosening of the structural balance.

In 2016, as the economic situation is forecast to improve slightly, the required adjustment is 0.5% of GDP. The DBP projects almost no change in the recalculated structural balance whereas the required adjustment is 0.5% of GDP, pointing to some deviation from the required adjustment path in 2016. Over 2015-16 taken together, the structural balance points to a significant deviation. The expenditure benchmark points to some deviation in 2016, but it continues to be met with a margin over 2015 and 2016 taken together. Therefore, an overall assessment is required. On the one hand, a temporary revenue shortfall linked to the low nominal growth environment negatively affects the structural balance. On the other hand, the potential growth rate underpinning the expenditure benchmark appears too high at the current juncture. Overall, the DBP points to some deviation from the required adjustment.

The Commission 2015 autumn forecast points to a 0.2% of GDP improvement in the structural balance in 2016, due to a wider output gap estimate compared to the DBP, resulting in deviation equivalent to 0.3% of GDP based on the structural balance pillar. Over two years, the deviation is 0.2% of GDP. Based on the expenditure benchmark pillar, the deviation in 2016 is -0.1% of GDP and over 2015 and 2016 taken together, the expenditure benchmark is met with a margin of 0.3% of GDP. The overall assessment based on the Commission 2015 autumn forecast takes into account that the difference in the potential growth rates used has a considerable positive effect (0.4% of GDP) on the expenditure benchmark. On that basis, the overall assessment based on the Commission 2015 autumn forecast points to a risk of some deviation from the required adjustment path towards the MTO in 2016.

Following an overall assessment of the Member State's DBP, with the structural balance as a reference, including an analysis of expenditure net of discretionary revenue measures, some deviation from the required adjustment path towards the MTO is to be expected in 2015 and 2016.

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4 While according to the figures in table 2 the structural balance seems to improve by 0.1% of GDP, this is only due to rounding.

Table 5: Compliance with the requirements of the preventive arm

(% of GDP)	2014	2015		2016	
Initial position[1]					
Medium-term objective (MTO)	-0.5	-0.5		-0.5	
Structural balance[2] (COM)	-1.8	-1.7		-1.5	
Structural balance based on freezing (COM)	-0.9	-1.7		-	
Position vis-a -vis the MTO[3]	At or above the MTO	Not at MTO		Not at MTO	
(% of GDP)	**2014**	**2015**		**2016**	
	COM	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.0	0.1		0.5	
Required adjustment corrected[5]	0.0	0.1		0.5	
Change in structural balance[6]	-0.8	-0.1	0.0	0.0	0.2
One-year deviation from the required adjustment [7]	-0.8	-0.2	-0.1	-0.5	-0.3
Two-year average deviation from the required adjustment [7]	0.2	-0.5	-0.4	-0.4	-0.2
Expenditure benchmark pillar					
Applicable reference rate[8]	0.8	0.6		-0.1	
One-year deviation [9]	0.3	0.9	0.6	-0.1	-0.1
Two-year average deviation [9]	0.5	0.6	0.5	0.4	0.3
Conclusion					
Conclusion over one year	Overall assessment	Overall assessment	Overall assessment	Overall assessment	Overall assessment
Conclusion over two years	Compliance	Overall assessment	Overall assessment	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 27.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2014) was carried out on the basis of Commission 2015 spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] 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.

[9] 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 for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations.

5. IMPLEMENTATION OF REFORMS IN THE AREA OF FISCAL GOVERNANCE

The DBP includes information on progress made in addressing the CSRs. As concerns the recommendation to continue efforts to reduce the fiscal sustainability gap and strengthen conditions for growth, the DBP confirmed that the pension reform is expected to enter into force on 1 January 2017. Regarding the other reforms that would enhance the sustainability, namely reforms in the social and healthcare services and regional administration reform, the government published its decision on 9 November 2015. In particular, it is foreseen that from 1 January 2019 basically 15 regions will organise healthcare and social services in their area, replacing the current 190 municipalities or joint municipalities with similar tasks..

The DBP also reports about the plans to tighten the obligation to accept work and to set an obligation to participate in activation measures. Based on the DBP, the youth guarantee system will be further strengthened. The government has also proposed a set of measures that would reduce labour costs and improve competitiveness. These are expected to be implemented once there is a broader agreement with social partners regarding the exact nature of the measures. To improve competition in retail, the government has proposed legislation to liberalize shop opening hours.

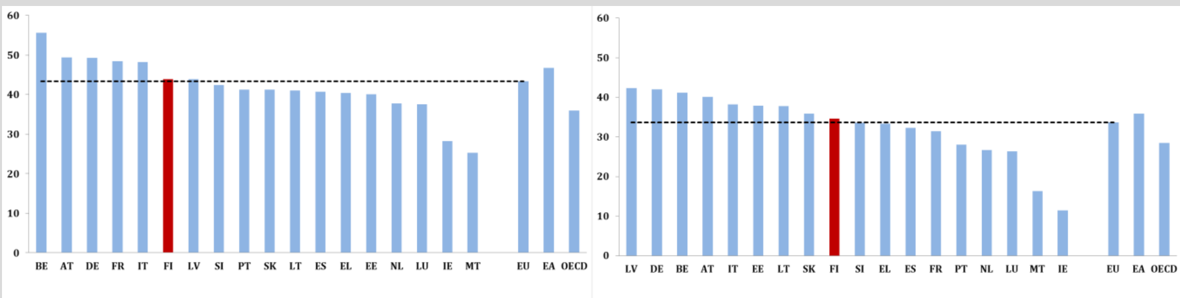
A comprehensive assessment of progress made with the implementation of the CSRs will be made in the 2016 Country Reports and in the context of the CSRs adopted by the Commission in May.

Box 4: Addressing the tax burden on labour in the euro area

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. Against this background, the Eurogroup has expressed a commitment to reduce the tax burden on labour. On 12 September 2015, the Eurogroup agreed to screen euro-area Member States' tax burden on labour against the GDP-weighted EU average, relying in the first instance on indicators measuring the tax wedge on labour for a single worker at average wage and a single worker at low wage. It also agreed to relate these numbers to the OECD average for purposes of broader comparability. Furthermore, the Eurogroup expressed its intention to take stock of the state of play in the reduction of the tax burden on labour when discussing the DBPs of euro-area Member States.

The tax wedge on labour measures the difference between the total labour costs to employ a worker and the worker’s net earnings. It is made up of personal income taxes and employer and employee social security contributions. The higher the tax wedge the higher the disincentives to take up work or hire new staff. The graphs below show the tax wedge in Finland for a single worker earning respectively the average wage and a low wage (50% of the average) compared to the EU average.

Tax burden on labour in Finland at the average wage and a low wage (2014)



Notes: Data for Latvia, Lithuania and Malta is for 2013. No recent data is available for Cyprus. EU and EA averages are GDP-weighted. The OECD average is not weighted.

Source: European Commission Tax and Benefit Indicator database based on OECD data.

This screening is only the first step in the process towards firm country-specific policy conclusions. The tax burden on labour interacts with a wide variety of other policy elements such as the benefit system and the wage-setting system. A good employment performance indicates that the need to reduce labour taxation may be less urgent while fiscal constraints can dictate that labour tax cuts should be fully offset by other revenue-enhancing or expenditure-reducing measures. In-depth, country-specific analysis is necessary before drawing policy conclusions.

Finland's DBP contains measure(s) that affect the tax wedge on labour. Among these, the most important is the decision of the social partners to increase the unemployment insurance contributions as of 2016 by 1pp, equally divided between employers and employees. The measure has been taken to balance the unemployment security system, which has been in deficit over the recent years due to the increase in unemployment. Ceteris paribus, this measure will increase the tax wedge and could have minor negative impact on employment and growth.

The DBP, however, also includes numerous reforms to reduce the taxation of lower incomes. In contrast to the previous plans, the annual adjustments to rising earnings and inflation to the progressive earned income tax scale will be carried out in 2016, thereby effectively lowering the income taxation. This does not apply for the highest incomes - the highest income bracket in the central government tax scale will remain in effect until 2019 and the limit where it applies from is reduced from 90,000 to 72,300 euros for 2016 and 2017. In addition, the taxation of lower incomes is reduced by increasing the tax credit for work income (earned income deduction) and by modifying the broadcasting company tax parameters, so that the lowest income limit at which the tax is levied will rise to ca 10,300 euros (per year).

The tax cuts for lower incomes are financed through tightening various other taxes. The tax rate for capital income exceeding 30,000 euros will be raised from 33% to 34%. Furthermore, the government will accelerate the reduction of the deductibility of mortgage interest expenditure as of 2016 and indirect taxation will be tightened, as taxes on tobacco, waste and energy taxes are increased. Overall, the measures are expected to provide additional incentive to work and to have a positive impact on growth and employment.

However, since at the same time the unemployment insurance contributions are set to increase as of 2016, the overall taxation of labour is not expected to be reduced.

6. KEY ELEMENTS OF THE UPDATED STABILITY PROGRAMME

As the Stability Programme presented in April 2015 was prepared by an outgoing government, the Programme was based on unchanged policies. Together with the DBP, the government has also presented an updated Stability Programme. For 2015 and 2016 the two documents are fully consistent in their macroeconomic scenario and budgetary developments.

The September 2015 Stability Programme assumes that real GDP would grow on average by 1.2% over 2017-19. The general government deficit is forecast to decline to 1.4% of GDP in 2019, while public debt is expected to continue increasing, reaching 66.6% in 2019. By 2019, the primary deficit is expected to disappear. The April 2015 Stability Programme forecast that the deficit would remain above 3% until 2018 and that debt would reach 67.8% in 2019. The September Stability Programme takes into account the impact of the measures taken by the new government to consolidate public finances.

In structural terms the general government balance is forecast to improve only slowly and to reach a deficit 1.4% of GDP in 2019 (at face value from the programme, not re-calculated by the Commission), almost 1 pp. away from the MTO. Based on the April 2015 Stability Programme the re-calculated structural balance would have deteriorated to -2.6% by 2017 and thereafter remained at -2.5%, 2 pps away from the MTO.

In this document, Finland has requested the activation of the structural reform and investment clauses in 2016. Regarding the structural reform clause, Finland is seeking to activate it based on the pension reform that is expected to be implemented from 2017. Finland is requesting the temporary deviation of 0.5% of GDP from the adjustment path based on this clause. Finland is also seeking a 0.1% of GDP temporary deviation based on its financial contribution towards the co-funded EU investment projects. However, Finland does not respect the required safety margin to the 3% of GDP deficit reference value of the Treaty, as the structural balance is projected to be below the minimum benchmark[5] of -0.5% of GDP.

7. OVERALL CONCLUSION

While the Stability Programme submitted in April 2015, which included projections on a no-policy-change basis, expected the general government deficit to remain above the 3%-of-GDP reference value of the Treaty in 2016 and 2017, the DBP includes measures to bring the deficit below 3% of GDP in 2016. The new government has submitted an updated Stability Programme where the general government deficit is forecast to continue to decline and reach -1.4% of GDP in 2019.

Based on the DBP and the Commission 2015 autumn forecast, the public debt-to-GDP ratio will exceed 60% in 2015 and it will continue to increase in 2016. Based on the September Stability Programme, it will reach 66.6% in 2019. On 16 November 2015, the Commission issued a report under Article 126(3) TFEU. The analysis concluded that after considering the relevant factors, both the deficit and the debt criterion should be considered as complied with. Finland's debt-to-GDP ratio has been on an increasing trend and under a no-policy-change-assumption it is forecast to continue rising over the medium term. The pension reform and other structural reforms, aiming to increase productivity and supply of labour, once adopted and implemented, could enhance Finland's growth prospects in the medium term and improve fiscal sustainability.

Based on both the DBP and the Commission 2015 autumn forecast, there is a risk of some deviation from the adjustment path towards the MTO in 2015 and 2016.

In its Stability Programme submitted in September Finland requests a temporary deviation of 0.5% of GDP from the required adjustment path towards the MTO in 2016 to take account of major structural reforms with a positive impact on the long-term sustainability of public finances and a temporary deviation of 0.1 % of GDP to take account of EU co-financed investments. However, Finland does not respect the required safety margin to the 3% of GDP deficit reference value of the Treaty.

5 For each Member State, the safety margin is estimated in the form of a minimum benchmark which takes into account past output volatility and budgetary sensitivity to output fluctuations. For further information, see "Vade mecum on the Stability and Growth Pact", European Economy, Occasional Paper 151, May 2013.