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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 for 2014 on 15 October 2013 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.

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission Autumn 2013 Forecast. The following section 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 2013-2014 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. Section 5 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The decline of the Finnish economy in 2012 was revised from 0.2% in the Stability Programme to 0.8% in the Draft Budgetary Plan based on the revision of statistical data between these publications. With the contraction continuing in the first quarter of 2013, the economy faced a recession for four consecutive quarters before returning to tepid growth in the second quarter of 2013.

The Finnish economy is forecast to register a negative real GDP growth also in 2013. The Draft Budgetary Plan forecasts the GDP to decline 0.5% in 2013 while according to the Commission 2013 Autumn Forecast the decline is projected to be 0.6%. This is a significant revision compared to the 2013 Stability Programme, where 0.4% growth was forecast in 2013. The Draft Budgetary Plan revises growth downwards for 2013 due to the downward revision of private consumption as well as external demand. Similarly, investments are expected to decline. Although export is seen declining, growth contribution from net exports is assumed to be still positive as decline in imports is projected to be steeper.

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

The macroeconomic forecasts underlying the Draft Budgetary Plan has been prepared by the Economics Department of the Ministry of Finance which is the national budgetary authority. The same forecast was used to prepare the central government budget proposal. This forecast is based on the data available on 29 August 2013. Based on the information available to the Commission at this stage, national authorities consider that the forecast is independent and it is stated that the regulatory changes to formally guarantee the independence of the Economics

Department are being prepared. When the regulatory framework to ensure independence from the budgetary authority is in place, the Commission will assess whether the macroeconomic forecast underpinning the Draft Budgetary Plan may be considered independently produced in the meaning of Reg. 473/2013.

In accordance with the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, Finland has appointed the National Audit Office as the body responsible for the independent monitoring and evaluation of fiscal policy. It could be expected that the same body would also endorse the macroeconomic forecasts underlying future Draft Budgetary Plans.

Table 1. Comparison of macroeconomic developments and forecasts

| | 2012 | 2013 | | | 2014 | | |
|---|------|------|------|------|------|------|------|
| | COM | SP | DBP | COM | SP | DBP | COM |
| Real GDP (% change) | -0.8 | 0.4 | -0.5 | -0.6 | 1.6 | 1.2 | 0.6 |
| Private consumption (% change) | 0.2 | 0.6 | 0.0 | -0.6 | 1.0 | 0.8 | 0.3 |
| Gross fixed capital formation (% change) | -1.0 | -2.5 | -4.0 | -1.1 | 2.8 | -0.8 | 1.0 |
| Exports of goods and services (% change) | -0.2 | 0.7 | -0.5 | -1.4 | 3.8 | 3.7 | 3.5 |
| Imports of goods and services (% change) | -1.0 | 0.5 | -0.7 | -1.9 | 3.3 | 3.0 | 4.1 |
| <i>Contributions to real GDP growth:</i> | | | | | | | |
| - Final domestic demand | 0.1 | 0.3 | -0.5 | -0.4 | 1.3 | 0.5 | 0.6 |
| - Change in inventories | -0.9 | 0.0 | -0.1 | -0.4 | 0.1 | 0.3 | 0.2 |
| - Net exports | 0.4 | 0.1 | 0.1 | 0.2 | 0.2 | 0.3 | -0.3 |
| Output gap ¹ | -1.8 | -1.9 | -3.3 | -2.7 | -1.3 | -2.9 | -2.5 |
| Employment (% change) | 0.0 | -0.5 | -0.7 | -0.6 | 0.1 | 0.1 | 0.0 |
| Unemployment rate (%) | 7.7 | 8.2 | 8.3 | 8.2 | 8.1 | 8.2 | 8.3 |
| Labour productivity (% change) | -0.8 | 1.0 | 0.2 | -0.1 | 1.4 | 1.1 | 0.6 |
| HICP inflation (%) | 3.2 | 2.7 | 2.3 | 2.2 | 2.4 | 2.2 | 1.9 |
| GDP deflator (% change) | 2.9 | 2.5 | 2.0 | 2.3 | 2.3 | 2.1 | 2.2 |
| Comp. of employees (per head, % change) | 3.5 | 2.5 | 2.2 | 2.4 | 2.7 | 2.3 | 1.6 |
| Net lending/borrowing vis-à-vis the rest of the world (% of GDP) | -1.7 | -1.0 | -1.5 | -1.1 | -0.6 | -1.2 | -1.2 |
| 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 : | | | | | | | |
| <i>Stability programme (SP); Draft Budgetary Plan (DBP); Commission services' 2013 Autumn Forecast (COM); Commission services' calculations.</i> | | | | | | | |

For 2014, GDP growth is forecast at 1.2% in the Draft Budgetary Plan with a downward revision of 0.4pp compared to the scenario in the 2013 Stability Programme. The growth in 2014 is founded on the recovery of private consumption and exports, while investments are expected to contract further. The Commission 2013 Autumn Forecast is, with a growth rate of 0.6%, less optimistic for consumption growth and forecasts imports to grow faster than exports.

The Draft Budgetary Plan assumes unemployment to reach 8.3% in 2013 and to decrease slightly in 2014, whereas according to the Commission 2013 Autumn Forecast, unemployment would be 8.2% in 2013 but increase by 0.1 pp in 2014. The Commission 2013 Autumn Forecast is expecting inflation to slow down to 1.9% in 2014, lower than the 2.2% forecast in the Draft Budgetary Plan.

Risks to the macroeconomic scenario are mainly external. Changes in export demand could significantly affect the employment and growth forecast.

Since the cut-off date of the forecast underlying the Draft Budgetary Plan, the Finnish trade unions and central employer organisations have reached a national agreement for wages and salaries, setting a moderate wage growth for 2014-15: a lump sum monthly increase of EUR 20 for the first 12 month period and a 0.4% increase for the second 12 month period. Compensation of employees is thus expected to rise significantly less than under the 2012-13 agreement, resulting in a more moderate increase in unit labour costs. Wage restraint, while weighing on private consumption in the short term, could help strengthening net exports, employment and growth in the medium term. The impact of the agreement is not taken into account in the forecast underlying the Draft Budgetary Plan. While the cut-off date for the Commission forecast was before the conclusion of the final wage agreement, the forecast took into account the main elements of the preliminary agreement reached in the end of August. Therefore the projected developments are different regarding the compensation of employees and private consumption developments.

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The Draft Budgetary Plan foresees a higher (-2.2% of GDP) general government deficit in 2013 compared with the projections made in the Stability Programme (-1.9%) for 2013. The Commission 2013 Autumn Forecast also estimates the deficit to reach -2.2% of GDP. The revision is due to base effect after statistical institute lowered actual GDP for 2012 and a significant revision of the growth forecast for 2013.

For 2014, the Draft Budgetary Plan foresees an improvement of the general government balance to -1.9% of GDP. This is somewhat weaker than the target in the Stability Programme (-1.3%). Both revenue and expenditure are forecast to be higher (as a share of GDP) than in the stability programme. Revenue is expected to reach 55.8% of GDP (54.8% in SP) and expenditure 57.7% of GDP (56.1% in SP). Regarding expenditure, the Draft Budgetary Plan is based on the expenditure ceilings decision made in April, when growth for 2013 as well as for 2014 was still forecast to be higher. Thus, with GDP lower in 2014 the expenditure to GDP ratio is revised upwards. The revenue to GDP ratio has also been revised upwards.

According to the Commission 2013 Autumn Forecast, general government balance would be -2.3% in 2014. The difference with the Draft Budgetary Plan stems mainly from the Commission's lower growth forecast for 2013 and 2014 and the resulting lower revenues, but also from the differences in the expenditure forecast. According to the Commission forecast, the expenditures, as share of GDP, will be higher in 2014, mainly for government intermediate consumption but also social expenditures. Compared to the Draft Budgetary Plan forecast, the Commission expects lower expenditure for the compensation of public sector employees, again based on the moderate wage growth agreement reached between social partners.

Risks to the fiscal forecast in the Draft Budgetary Plan arise from the macroeconomic scenario that could affect revenue collection. In particular, lower disposable income growth could reduce revenues from direct taxes and lower consumption could lead to lower collection of consumption taxes.

Table 2. Composition of the budgetary adjustment

| (% of GDP) | 2012 | 2013 | | | 2014 | | | Change: 2012-2014 |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|----------------------|
| | COM | SP | DBP | COM | SP | DBP | COM | DBP |
| Revenue | 54.4 | 54.4 | 55.5 | 55.2 | 54.8 | 55.8 | 55.7 | 1.4 |
| <i>of which:</i> | | | | | | | | |
| - Taxes on production and imports | 14.4 | 14.6 | 14.9 | 14.7 | 14.7 | 14.9 | 14.8 | 0.5 |
| - Current taxes on income, wealth, etc. | 16.0 | 16.3 | 16.5 | 16.4 | 16.4 | 16.3 | 16.3 | 0.3 |
| - Capital taxes | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.0 |
| - Social contributions | 13.3 | 12.9 | 13.2 | 13.2 | 13.0 | 13.4 | 13.5 | 0.1 |
| - Other (residual) | 10.4 | 10.3 | 10.6 | 10.6 | 10.4 | 10.9 | 10.8 | 0.5 |
| Expenditure | 56.2 | 56.3 | 57.7 | 57.5 | 56.1 | 57.7 | 58.0 | 1.5 |
| <i>of which:</i> | | | | | | | | |
| - Primary expenditure | 55.1 | 55.3 | 56.7 | 56.4 | 55.1 | 56.7 | 57.0 | 1.6 |
| <i>of which:</i> | | | | | | | | |
| Compensation of employees | 14.5 | 14.3 | 14.7 | 14.5 | 14.2 | 14.5 | 14.3 | 0.0 |
| Intermediate consumption | 11.7 | 11.9 | 12.1 | 12.1 | 11.9 | 12.1 | 12.5 | 0.4 |
| Social payments | 21.5 | 21.8 | 22.5 | 22.4 | 21.9 | 22.7 | 22.8 | 1.2 |
| Subsidies | 1.4 | 1.4 | 1.4 | 1.4 | 1.3 | 1.4 | 1.4 | 0.0 |
| Gross fixed capital formation | 2.6 | 2.6 | 2.6 | 2.6 | 2.6 | 2.6 | 2.6 | 0.0 |
| Other (residual) | 3.3 | 3.3 | 3.4 | 3.4 | 3.2 | 3.4 | 3.4 | 0.1 |
| - Interest expenditure | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 | 0.0 |
| General government balance (GGB) | -1.8 | -1.9 | -2.2 | -2.2 | -1.3 | -1.9 | -2.3 | -0.1 |
| Primary balance | -0.7 | -0.9 | -1.2 | -1.2 | -0.3 | -0.9 | -1.3 | -0.2 |
| 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 | -1.7 | -1.9 | -2.2 | -2.2 | -1.3 | -1.9 | -2.3 | -0.2 |
| Output gap ¹ | -1.8 | -1.9 | -3.3 | -2.7 | -1.3 | -2.9 | -2.5 | -1.1 |
| Cyclically-adjusted balance ¹ | -0.8 | -0.9 | -0.5 | -0.8 | -0.6 | -0.4 | -1.0 | 0.5 |
| Structural balance (SB)² | -0.7 | -0.9 | -0.5 | -0.8 | -0.6 | -0.4 | -1.0 | 0.4 |
| <i>Change in SB</i> | <i>-0.4</i> | <i>0.1</i> | <i>0.2</i> | <i>-0.1</i> | <i>0.3</i> | <i>0.1</i> | <i>-0.2</i> | <i>-</i> |
| <i>Two year average change in SB</i> | <i>0.1</i> | <i>-0.4</i> | <i>-0.1</i> | <i>-0.3</i> | <i>0.2</i> | <i>0.1</i> | <i>-0.1</i> | <i>-</i> |
| Structural primary balance ² | 0.3 | 0.1 | 0.5 | 0.2 | 0.4 | 0.6 | 0.1 | 0.3 |
| <i>Change in structural primary balance</i> | | <i>0.0</i> | <i>0.1</i> | <i>-0.1</i> | <i>0.3</i> | <i>0.1</i> | <i>-0.2</i> | <i>-</i> |
| Expenditure benchmark | | | | | | | | |
| Applicable reference rate ³ | 0.51 | 0.5 | 0.5 | 0.5 | -0.13 | 0.78 | -0.13 | - |
| Deviation ⁴ (% GDP) | 0.0 | 0.1 | 0.0 | 0.3 | 0.4 | 0.2 | 0.8 | - |
| Two-year average deviation (% GDP) | 0.2 | -0.1 | 0.0 | 0.2 | 0.2 | 0.1 | 0.6 | - |

Notes:

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

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

³ 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.

⁴ Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A positive sign implies that expenditure growth exceeds the applicable reference rate.

Source:
Stability programme (SP); Draft Budgetary Plan (DBP); Commission services' 2013 Autumn Forecast (COM); Commission services' calculations.

According to the DBP, the structural balance¹ is -0.5% of GDP in 2013 and improves to -0.4% in 2014. Thus, Finland would reach the Medium-Term Objective (MTO) in 2013 and stay at MTO in 2014. However, according to the Commission 2013 Autumn Forecast, in 2013 the structural balance would slightly worsen compared to the 2012 level and decline to -1% in 2014.

3.2. Debt developments

According to the Draft Budgetary Plan the general government gross debt ratio is expected to grow from 53.6% of GDP in 2012 to 58.3% in 2013 and to 60.7% in 2014, thus breaching the Treaty threshold. This means a significantly higher debt path compared to the Stability Programme. Underlying factors are the expected worsening of the primary balance for both years as well as the negative growth rate of GDP and a lower inflation (GDP deflator), with the latter two developments reducing the denominator and thus increasing the ratio compared with earlier forecasts.

Table 3. Debt developments

| (% of GDP) | 2012 | 2013 | | | 2014 | | |
|-------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| | | SP | DBP | COM | SP | DBP | COM |
| Gross debt ratio¹ | 53.6 | 56.3 | 58.3 | 58.4 | 57.3 | 60.7 | 61.0 |
| Change in the ratio | 4.4 | 2.7 | 4.7 | 4.8 | 1.0 | 2.4 | 2.6 |
| <i>Contributions²:</i> | | | | | | | |
| 1. Primary balance | 0.7 | 0.9 | 1.2 | 1.2 | 0.3 | 0.9 | 1.3 |
| 2. “Snow-ball” effect | 0.0 | -0.5 | -0.1 | 0.2 | -1.1 | -1.4 | -0.5 |
| <i>Of which:</i> | | | | | | | |
| Interest expenditure | 1.0 | 1.0 | 0.7 | 1.0 | 1.0 | 0.4 | 1.0 |
| Growth effect | 0.4 | -0.2 | 0.3 | 0.3 | -0.9 | -0.7 | -0.3 |
| Inflation effect | -1.4 | -1.3 | -1.1 | -1.2 | -1.2 | -1.2 | -1.2 |
| 3. Stock-flow adjustment | 3.6 | 2.3 | 3.6 | 3.5 | 1.8 | 3.0 | 1.9 |
| <i>Of which:</i> | | | | | | | |
| Cash/accruals difference | | 0.0 | n.a. | | 0.0 | n.a. | |
| Net accumulation of financial | | 2.1 | n.a. | | 2.1 | n.a. | |
| <i>of which privatisation</i> | | | | | | | |
| <i>proceeds</i> | | -0.2 | n.a. | | -0.2 | n.a. | |
| Valuation effect & residual | | -0.7 | n.a. | | -2.4 | 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 effects.

Source:

Stability programme (SP); Draft Budgetary Plan (DBP); Commission services' 2013 Autumn Forecast (COM); Commission services' calculations.

According to the Commission 2013 Autumn Forecast, public debt is expected to reach 58.4% of GDP in 2013 and 61.0% in 2014. There are no significant differences for 2013 in the estimates, but for 2014 the Commission forecasts a lower primary balance and smaller positive effect from GDP growth.

¹ 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.

For Finland the stock-flow adjustment has a significant effect on the changes in the general government debt. This is driven by the fact that the earnings-related pension system included in the general government sector is pre-funded and is showing surpluses. The surplus was 2.5% of GDP in 2012 and is forecast by the national authorities at 2.1% of GDP for 2013 and 2014. While these surpluses are improving the general government balance, they are not reducing general government debt. These funds show up as net accumulation of financial assets under stock-flow adjustments². It has to be noted that the net assets are also declining – in parallel with the increasing public debt level.

Finland's general government gross debt includes EUR 2.7 billion arising from the European Financial Stability Facility loans to the crises countries. Further EUR 1.3 billion arise from the capitalisation of the European Stability Mechanism. Based on the Commission 2013 Autumn Forecast, the projected debt ratio for Finland reaches 58.1% of GDP, if the amounts mobilised during the crises would be excluded from the general government debt.

Risks to the development of gross debt ratio mainly stem from the macroeconomic forecast. Risks related to contingent liabilities, guarantees, financial rescue operations and debt assumptions are limited.

3.3. Measures underpinning the Draft Budgetary Plan

From the perspective of fiscal policy, the most important reform introduced in the Draft Budgetary Plan for 2014 will be the reduction of the corporate income tax rate from 24.5% to 20%. It is estimated that this reduction will decrease revenues by 0.4% of GDP. This will be partly compensated by higher taxation of dividends. Taxes of products (sweets, alcohol and tobacco) will also be increased. Pension contributions will increase according to the path determined by social partners, who bear the main responsibility in determining the contributions for the unemployment insurance and the earning-related pension scheme. According to the Draft Budgetary Plan, discretionary measures increase revenue by 0.3% of GDP and decrease expenditures also by 0.3% of GDP.

The Draft Budgetary Plan does not incorporate the results of the labour market agreement of 25 October 2013. The agreement foresees a moderate wage growth over 2014-15 period. The agreement can be seen as an important step to limit unit labour cost growth. The government has promised to end the freezing of the income tax scales that was initially foreseen to be continued also in 2014. Furthermore, the government will forego putting further limitations on the personal car use compensations paid by enterprises to employees and promised to lower some taxes collected from sea and rail traffic. Unemployment security contributions will be lowered both for employers as well as for employees. Temporary employment will be supported by protecting parts of housing allowance and unemployment allowance, so that unemployed will have incentives to accept temporary or part-time jobs.

The government has announced plans for structural reforms in the areas of labour market, public sector efficiency, business environment and competitiveness. The plan is a welcomed step that supports the progress in several Country Specific Recommendations. However, the plan has not been developed in sufficient detail to consider any impact arising for the budget of 2014.

² According to the statistical annex of the OECD Economic Outlook (September 2013), the net financial assets of Finland's general government will amount to 47.1% in 2014. From OECD countries, only Norway would have higher net assets while most countries have large net liabilities.

Table 4. Main discretionary measures reported in the DBP

| Components | Budgetary impact (% GDP) (as reported by the authorities) | | |
|---|---|------|------|
| | 2013 | 2014 | 2015 |
| Taxes on production and imports | 0.6 | 0.3 | 0.1 |
| Current taxes on income, wealth, etc. | 0.4 | -0.3 | 0 |
| Capital taxes | n.a. | n.a. | n.a. |
| Social contributions | 0 | 0.3 | 0.3 |
| Property Income | n.a. | n.a. | n.a. |
| Other | n.a. | n.a. | n.a. |
| Total | 1 | 0.3 | 0.4 |
| <u>Note:</u> | | | |
| 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. | | | |
| <u>Source:</u> Draft Budgetary Plan | | | |
| Discretionary measures taken by General Government - expenditure side | | | |
| Components | Budgetary impact (% GDP) (as reported by the authorities) | | |
| | 2013 | 2014 | 2015 |
| 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 | n.a. | -0.3 | -0.6 |
| Total | n.a. | -0.3 | -0.6 |
| <u>Note:</u> | | | |
| 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. | | | |
| <u>Source:</u> Draft Budgetary Plan | | | |

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT**Box 2. Council recommendations addressed to Finland**

On 9 July, the Council addressed recommendations to Finland in the context of the European Semester. In particular, in the area of public finances the Council recommended to Finland to pursue a growth-friendly fiscal policy and preserve a sound fiscal position as envisaged, ensuring compliance with the MTO over the Programme horizon. Continue to carry out annual assessments of the size of the ageing-related sustainability gap and adjust public revenue and expenditure in accordance with long-term objectives and needs. Ensure the cost-effectiveness and sustainability of long-term care and put a stronger focus on prevention, rehabilitation and independent living.

4.1. Compliance with the MTO

Finland's structural balance has been calculated by the Commission to be -0.7% of GDP in 2012. During 2012, Finland's MTO was achieving a structural surplus of 0.5% of GDP. Thus, Finland was not at MTO in 2012. The 2013 Stability Programme changed the MTO to -0.5% of GDP.

According to the Draft Budgetary Plan the structural balance in 2013 is calculated to be -0.5% of GDP, whereby Finland would meet its MTO in contrast to the calculation in the Stability Programme expecting a structural balance of -0.9%. Finland does not report on temporary measures which would cause the structural balance to differ from the cyclically-adjusted balance. According to the Commission 2013 Autumn Forecast, the structural balance is forecast to slightly deteriorate to -0.8%, not meeting the MTO.

According to the information provided in the Draft Budgetary Plan, in 2013 the growth rate of government expenditure, net of discretionary revenue measures, is expected to contribute to an annual structural adjustment towards the MTO. This is because the growth rate of this expenditure is 0.5%, the lower rate under the expenditure benchmark. According to the Commission 2013 Autumn Forecast, the growth rate slightly exceeds the applicable reference rate. Overall, in 2013 the adjustment path towards the MTO seems to be appropriate and compliant with the requirement of the preventive arm of the Pact.

According to the Draft Budgetary Plan, the structural balance would further improve in 2014, so that Finland would stay at MTO. With higher deficit and less steep output gap, the Commission calculates the structural balance to be -1%., ca 0.2 pp. worse than for 2013. According to this calculation, the effort towards the MTO would be insufficient. Taking into account that 0.3% improvement would be needed to reach the MTO in 2014, the deviation would reach 0.5% of GDP from the appropriate adjustment. Hence, there is a risk of significant deviation in 2014.

As, according to the Draft Budgetary Plan, the MTO is achieved in 2013, the applicable reference rate for the expenditure benchmark in 2014 is the medium-term rate of potential GDP growth of 0.78%. The growth rate of government expenditure, net of discretionary revenue measures, will exceed this rate, but the deviation is not considered to be significant.

Based on the Commission 2013 Autumn Forecast, Finland would not meet the MTO in 2013 and thus for 2014, the lower rate under the expenditure benchmark (-0.1%) should be used. Compared to this rate the deviation would be significant, amounting to 0.8% of GDP. Also the deviation over two years would be significant.

Overall, provided that Finland will be at MTO in 2013 the Draft Budgetary Plan scenario for 2014 is appropriate and compliant with the requirement of the preventive arm of the Pact. However, taking into account the risks to the growth and deficit forecasts, a deviation from the adjustment path towards the MTO is to be expected in 2014 which, if repeated the following year, could be assessed to be significant and could put under risk the compliance with the requirements of the preventive arm of the Pact. In turn, if Finland does not reach the MTO in 2013, a significant deviation from the adjustment path towards the MTO could occur in 2014 putting under risk the compliance with the requirements of the preventive arm of the Pact.

4.2. Compliance with the debt rule

The gross debt-to-GDP ratio is forecast to breach the 60% of GDP threshold in 2014 due to several years of persistently weak growth and high deficits. The ratio increase is affected by negative and slow growth over 2013-14, negative balance and stock-flow adjustments arising from the fact that social security surpluses are not used to repay central- or local government

debt. It is also important that the increase can be partly attributed to Finland's share in the EU measures targeted to fight the crises. Excluding the effect of the debt incurred in the form of multilateral support between Member States (financial contributions to EFSF/ESM) the gross debt-to-GDP ratio is forecast to be 58.1% of GDP.

4.3. Other considerations

The Draft Budgetary Plan refers to the broad structural reform programme for improving the growth conditions and reducing the sustainability gap, adopted by the government on 29 August 2013. A special working group of high level government officials has been set up to provide more substance over autumn 2013. The ultimate success and fiscal impact will be clearer only once relevant details are published.

The programme recognizes the severity of the fiscal sustainability challenges, highlighted also in the CSRs. The sustainability gap for Finland is now assumed at 4.5% of GDP, revised up from the 2013 Stability Programme, where it was estimated to be 4.2% of GDP. The programme emphasizes the role of aging-related expenditures (pensions, healthcare and long-term care) as the risk factors endangering the long-term sustainability.

The government is foreseeing measures to balance local government finances, contributing to the recommendations to ensure a sound fiscal position and to increase the efficiency of the public sector services provision.

The second pillar of the programme is formed by measures targeting the labour market, addressing the relevant CSR. The programme sets a target to extend careers by 2 years.

The programme also foresees measures to improve competition and competitiveness, also areas covered by CSRs. The emphasis is on improving the competition on product markets and R&D. The government promises to reduce regulatory burden for enterprises, but exact measures are not given. The success depends on how far-reaching such reforms will be. It is also foreseen to reform the enterprise support system and to focus on growth and internationalization.

The programme does not include any additional immediate measures to balance the central government budget; these will be decided in spring 2014. This is in line with the usual practice as decisions regarding the budget (changes in taxes, important new programmes and initiatives) are made in a special governmental session in late March or early April. The programme does not specify the measures that could be taken to achieve consolidation.

The programme could have a significant positive effect on public finances over the medium term, but no immediate effect for 2014 can be calculated.

5. SUMMARY

Overall, Finland has taken adjustment measures deemed necessary to limit the deficits and move towards the MTO. However, the economic situation has constantly proved to be worse than expected and the adjustment measures have not resulted in a significant reduction of the deficit. Nevertheless, these measures have been sufficient to keep the annual deficit well below the 3% of GDP threshold.

Weak growth and still high deficits have led to the situation where gross debt is forecast to pass 60% of GDP. The ratio increase is affected by negative or low growth over 2013-14, continued deficits and due to stock-flow adjustments arising from social security surpluses that are not used to repay central- or local government debt. It is also important that the rise in the debt level is attributable to Finland's share in the multinational measures targeted to fight the crises. Excluding the effect of the debt incurred in the form of multilateral support

between Member States (financial contributions to EFSF/ESM) the gross debt-to-GDP ratio is forecast to be 58.1% of GDP.

With growth expected to return in 2014, Finland plans to marginally improve the structural balance. The Draft Budgetary Plan foresees a deviation from the expenditure benchmark based on the medium-term growth rate.

Overall, based on the 2013 Autumn Forecasts forecast, the Commission is of the opinion that there is a risk that the Draft Budgetary Plan sent on 15 October will not fulfil the requirements of the preventive arm. In particular, the Commission 2013 Autumn Forecast points to a non-compliance with respect to the adjustment path towards the MTO in 2014.