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2003 UPDATE

OF THE STABILITY PROGRAMME FOR FINLAND
(2003-2007)

AN ASSESSMENT

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SUMMARY AND CONCLUSIONS¹

The November 2003 update of the Finnish stability programme foresees a marked acceleration of GDP growth to 2.7% in 2004, almost double the growth rate expected for 2003. Between 2005 and 2007, growth is projected at around 2½% p.a. exceeding the potential output by nearly ½ percentage point. Consequently, the negative output gap is seen to close in the last year of the programme period, from a gap of over 1.3 p.p. in 2003 due to the downturn in economic activity. This fifth update of the stability programme assumes, from 2004 onwards, a broadly similar profile of output as the previous programme. Growth contributions from different demand components have been modified somewhat, as the external contribution appears stronger in the current programme whereas support from domestic demand is slightly weaker. In 2003, employment creation has been relatively resilient to the slowdown in activity. Consequently, unemployment is expected to remain unchanged at a rate of 9.1% in 2003 and with growth accelerating, to decline from 2004 onwards. Inflation is expected to bottom out at 0.7% by 2004² due mainly to tax cuts on alcohol beverages and the absence of external price shocks, and thereafter resumes its earlier trend of around 2% as economy expands and the impact of the tax cuts phases out. Apart from a higher growth estimate for 2004, the programme's short-term projections compare reasonably well with the Commission's own evaluation, notably the Autumn 2003 forecast.

The updated programme foresees a significant decline in the general government surplus from 4.2% of GDP in 2002 to 1.7% in 2004. This is due partly to cyclical factors, which weaken the financial position of the central government, and partly to increased spending introduced in the new government's programme. In addition, according to the programme, increasing external tax competition will make for some erosion in tax bases. In 2005 and beyond, the surplus is expected to edge up only slightly and stabilise somewhat above 2% of GDP, despite growth exceeding potential. Nevertheless, the projected path of the government balance shows that public finances in Finland will provide necessary safety margin against a breach of the 3% of GDP reference value throughout the programme period. The major contribution to the trend fall in the surplus ratio comes from the deterioration of central government finances which are estimated to slip into deficit as from 2003. As a result, the updated programme suggests that the government's aim of having central government finances in balance at the end of its term in 2007 will not be met. Furthermore, local government finances are foreseen to remain in deficit throughout the programme period. Indeed, according to the programme, the general government financial surplus in 2003-07 rests solely on the surplus of the social security funds and, moreover, on that of the earnings-related pension funds preparing for financial pressures stemming from an ageing population. The cyclically-adjusted balance is projected to decline by over ½ percentage points of GDP in 2003-05. Still, according to the programme, the cyclically-adjusted budgetary surplus should remain higher than 2% of GDP throughout the programme period. This should still leave enough leeway against any normal fluctuations in activity. The cyclically-adjusted surplus is forecast to fall by 0.2

¹ This assessment has been carried out on the basis of information available as of 22.12.2003.

² Due to the end of the transition period for free import of alcohol and tobacco from other EU countries and the acceding countries joining the EU amounting to a estimated loss of tax revenue amounting to close to 0.4% of GDP.

percentage points of GDP between 2005 and 2007. These are broadly in line with the Commission cyclically adjusted balance calculations.

The latest programme projects general government debt to fall at a somewhat faster pace (-0.3 p.p.) between 2003 and 2004 than the 2002 programme, although the debt ratio was less favourable than targeted in 2002. However, unlike in the previous programme, a rise in the debt ratio is expected for 2004-06, owing to a slightly lower nominal GDP estimate and deficit in central government finances³. In addition, the process of debt reduction is hampered by financial transactions i.e. the ongoing diversification of social security institutions' assets away from central government bonds and the accumulation of earnings-related pension fund assets of the central government.

The government programme includes a plan to cut income taxes by at least € 1.12 billion or 0.8% of GDP during its term with a view to boosting employment creation. According to the update, the bulk of these tax cuts have been frontloaded into the 2004 budget proposal. This measure can be justified against the background of the cyclical slowdown and the earlier healthy budgetary position and a high overall tax burden on labour. Moreover, the tax cut is accompanied by tight multi-annual spending ceilings in the central government finances in 2004-07.

The update foresees general government expenditure to remain at a virtually constant 48³/₄% of GDP between 2003 and 2007. While rising social transfers and local government financing will exert upward pressure, the multi-annual spending limits implemented by the new government are to keep expenditure under tight control. According to the update, central government expenditure in the 2004 budget proposal, excluding interest payments, is up by 4% in real terms from 2003. Half of the increase derives from appropriations increases forced by current legislation and decisions made by the previous government, and the other half from the spending increases and compensations included in the new government's programme. The 2004 budget proposal is forecast to be below the spending ceilings agreed in May 2003.

The recently adopted legislation requires municipalities to maintain a balance in their finances over a three-year planning period. Yet, according to the programme, local government finances are expected to show deficits over the whole period from 2003 to 2007. Therefore, the government needs to strengthen implementation of the legislation through careful monitoring⁴ of municipal finances.

The 2003 updated programme contains a detailed section on the sustainability of public finances, supplemented by national budgetary projections for public expenditures and revenues up to 2050. They show that age-related expenditures are projected to increase by some 6 percentage points of GDP between 2005 and 2050, while revenues are projected to increase by some 1 percentage point of GDP over the same period. Nevertheless, public finances in Finland seem relatively well set toward meeting the budgetary consequences on ageing population. This is largely reflected by the

³ There has been a technical change in the classification of central government debt, the repo portfolio i.e. central government debt held by the State Treasury itself has been removed from the Treasury's balance sheet as it was no longer needed for government debt servicing. As a result, the debt ratio to GDP has increased by 3.2 percentage points in 2003 compared with the previous programme.

⁴ Local governments are administratively fairly independent in Finland.

sustained running of a budget surplus which is leading to a rather swift pace of debt reduction in the long term. Even though the general government surplus is set to decline somewhat over the programme period, gross debt will continue to fall over the coming two decades, as a result of an explicit policy goal. In addition, the sustainability of public finances is supported by a pension system that is to a large extent pre-funded⁵. The recent reforms⁶ of pension and unemployment insurance systems should help to contain the long-term expenditure pressures⁷. Some of the budgetary benefits, however, seem to materialise with a considerable lag.

A long-term challenge may result from the fact that the projected sustainability of public finances is based on the assumption of a tax ratio of close to 44% of GDP in coming decades. Apart from the current concerns about the disincentives of high labour costs for job creation, the desirability of maintaining such high tax ratios over the very long run may also be contested by the increasing mobility of production factors (and consequently tax bases) in the context of globalisation.

The updated programme is broadly consistent with the recommendations by the Council in the Broad Economic Policy Guidelines (BEPGs) of 2003-05, as the government has introduced the multi-annual spending limits to control budgetary expenditures and put forward measures to reduce structural employment and enhance competition. In addition measures have been taken to improve the efficiency of the public sector.

1 INTRODUCTION

The government on 27 November 2003 approved Finland's updated stability programme. This is the fifth annual update of the programme presented originally in September 1998. Last year's update covered the period up to 2006. It was assessed by the Commission and by the Economic and Financial Committee, and the Council gave its opinion on 4 February 2003⁸.

The current update covers the period 2003-2007. Up until 2004, its macro-economic scenario is based on the November 2003 forecast by the Ministry of Finance, which deviates from the macro-economic assumptions underlying the government's 2004 budget proposal presented on September 16th 2003. As a consequence, the public finance projections of the programme for the year 2004 differ somewhat from those included in the budget proposal. Beyond 2004, the programme uses projections based on the longer-term growth potential.

According to the updated programme, the Finnish government maintains the objective of improving the fundamentals for sustainable economic growth, ensuring the competitiveness of the environment for entrepreneurship and enhancing the

⁵ The market value of statutory earnings-related pension funds assets was some 51% of GDP in 2002.

⁶ E.g. termination of certain early-retirement schemes, incentives to encourage older workers to remain in the labour force and mechanisms to adjust pension entitlements in line with changes in life expectancy.

⁷ Still, further steps are planned, *inter alia* dealing with pension systems in the public sector.

⁸ The Council Opinion on Finland's updated Stability Programme was published in the *Official Journal* C 26 of 4.2.2003.

functioning of markets. A budgetary strategy aiming at maintaining strong public finances is considered the best way to foster economic stability as well as growth. In particular, securing strong central government finances with the aim of balance at the end of the electoral term in 2007 and reducing the public debt are measures which are expected to give the necessary room for manoeuvre to deal with both cyclical fluctuations and future age-related expenditure pressures. However, the target of central government finances being in balance in 2007 may be difficult to achieve if the main economic policy objective of the government, 100 000 new jobs by 2007, fails to realise. The estimates in the programme show that the aim of balanced central government finances fall short if the baseline scenario of employment development materialises.

The 2003 update of the stability programme is in line with the Code of Conduct endorsed by the Council⁹. The programme presents, in particular, a long-term analysis of issues related to the ageing of the population. Moreover, the programme presents planned measures to bring down structural unemployment and to promote employment. In addition, it mentions that local government finances are being monitored to ensure that municipalities will meet their obligation of maintaining a close to balance financial position within a three-year period.

On the 2002 update of the stability programme the Council noted that the Finnish general government surplus was projected to remain at a fairly high level throughout the period 2002-06. The 2003 update sees the general government financial position to be at a lower level by 0.4-0.7 percentage points between 2003-07 from the previous programme (see table 2. of this note), but still maintaining favourable surpluses. This seems to follow mainly from weaker central government finances due to tax cuts and increased spending compared with the previous programme projections. This, in turn, appears to be leaving general government debt in 2003-07 higher in relation to GDP compared with the target in the previous programme. The updated programme largely adheres to the budgetary policy recommendations in the Broad Economic Policy Guidelines (BEPGs) of 2003-05, as the government has introduced multi-annual spending limits to control budgetary expenditures.

2 MACROECONOMIC ASSESSMENT

2.1 Developments in the current year

Growth in 2003, currently estimated at 1 ½% and down from 2.2% in 2002, is significantly weaker than anticipated in 2002. This is stemming mainly from weaker than expected development in the global economy. However, prospects have improved during the second half of 2003 and they have been taken into account in the programme as short-term macro-economic projections assume somewhat stronger growth for 2003 and 2004, compared with the short-term outlook of the 2004 budget proposal in September 2003.

⁹ On 10 July 2001 the ECOFIN Council endorsed the Opinion of the Economic and Financial Committee and the Code of Conduct on the content and format of the Stability and Convergence Programmes.

In the second quarter, the Finnish economy resumed growing, following a decrease in the first quarter of 2003. With exports rebounding and private consumption continuing to support growth, GDP grew by 0.8% on the quarter. In the third quarter, household consumption continued to support GDP which grew by 0.8% from the second quarter. Due to the downturn in economic activity, employment creation is expected deteriorate in 2003. However, the unemployment rate is seen to be unchanged from 2002 as labour force will shrink. Stemming from moderate import prices and lower prices of services, HICP inflation has been easing during 2003, remaining well below the euro area level.

2.2 External economic assumptions

The macroeconomic scenario is based on the national short-term forecast for 2003-04, finalised in November 2003. The external assumptions are based on the Commission services' Autumn 2003 forecast of growth in global economy picking up gradually in 2003-04. The projections from 2005 onwards are based on the surveys of the longer-term growth potential of the Finnish economy assuming decelerating trend growth in the population of working age. In view of the baby boom generation approaching retirement age towards the end of the programme period, these assumptions appear plausible.

2.3 Macroeconomic developments in 2004 and beyond

The short-term macro-economic projections of the programme assume somewhat stronger growth for 2004, compared with the short-term outlook of the 2004 budget proposal of September 2003. This stems from the fact that prospects for 2004 have improved during the second half of 2003. Based on the assumption of a recovery of the external contribution to growth and continued solid support from household consumption, activity should gather momentum reaching a rate of growth of 2.7% in 2004. Towards the later years of the programme period, however, GDP growth is foreseen to abate to around 2½%.

Unemployment is seen to go down in 2004, following the pick-up in growth. Unemployment rate remains well above the average for the euro area, even though the gap appears to be narrowing from 2004 onwards. The labour market trend seems broadly plausible; it is in line with the Commission estimates, although the Commission is somewhat more pessimistic of the unemployment development in 2004-05 compared with the programme estimates.

The programme presents virtually no information on wage developments. It is only briefly noted, that real wages are expected to evolve in line with the average growth in productivity. On the basis of collective wage agreements reached in 2002¹⁰, the Commission expects nominal wage growth to decelerate slightly to 3½% in 2004 from an estimated 4% in 2003. Still, given strong wage moderation for most of the 1990s, the competitive position of the Finnish companies remains relatively good.

¹⁰ A collective wage agreement for the years 2003 and 2004 was concluded in December 2002. It awards increases of nominal wages of 2.9% in 2003 and 2.2% in 2004.

For 2004, inflation is seen to moderate even further, due partly to the lowering of excise taxes on alcohol. For the rest of the programme period inflation is envisaged to accelerate as economic activity picks up. Eventually, inflation is expected to resume its earlier trend of around 2%. Table 1 compares the macroeconomic forecasts of the programme and the Commission services.

Table 1. Macroeconomic scenario – forecast comparison

Economic Forecasts 2003-2005 (Annual average growth rate, in %)							
	2002	2003		2004		2005	
	NA	SP 1)	COM 2)	SP 1)	COM 2)	SP 1)	COM 2)
GDP	2.2	1.4	1.5	2.7	2.5	2.5	2.7
Private consumption	1.5	3.2	3.2	2.6	2.5	2.0	2.6
Exports (Goods & Services)	4.9	1.6	1.6	5.1	4.2	5.1	5.8
Imports (Goods & Services)	1.3	1.5	1.1	4.0	4.0	3.7	5.5
Gross fixed capital formation	-4.0	-4.0	-2.7	1.1	0.5	0.7	2.3
HICP a)	2.0	1.0	1.4	0.7	1.0	1.3	1.7
Employment growth	0.2	-0.2	-0.2	0.3	0.2	0.3	0.4
Unemployment b)	9.1	9.1	9.3	8.8	9.2	8.4	9.1
Budget balance (% of GDP)	4.2	2.3	2.4	1.7	1.7	2.1	1.9
Debt (% of GDP)	42.7	45.1	44.6	44.7	44.5	44.9	44.3

SP = Stability Programme; COM = Commission Autumn forecast; NA = National Accounts
a) CPI forecasts in SP b) % of Labour Force
1) November 2003 2) October 2003

The government projections are relatively close to those of the Commission Autumn forecasts for 2003-05. However, there are some minor differences in the growth profile, as the Commission projects GDP growth to be 2.5% in 2004 and 2.7% in 2005, whereas the programme expects output to grow by 2.7% in 2004 and 2.5% in 2005. Overall, the Commission expects more support to growth from domestic demand, while the programme sees external demand to provide a higher contribution to economic activity.

On the whole, the macroeconomic scenario of the programme appears plausible. Nevertheless, some downside risks should not be neglected. In particular, a prolonged weakness in external demand would be particularly felt in the Finnish knowledge-based and forest industries. Furthermore, if this would translate into sluggish domestic demand, it may lead to higher than expected unemployment. According to the slow-growth scenario (assuming weaker growth by 1 percentage point) the rise in the unemployment rate would accelerate, leading to a jobless rate of about 10% for the whole of the programme period.

3 BUDGETARY TARGETS AND MEDIUM-TERM PATH OF PUBLIC FINANCES

3.1 Programme overview

The key fiscal policy objective is to reduce central government indebtedness and to secure sustainability of central government finances. The latest stability programme update confirms the budgetary policy strategy of the previous programme of creating a sizeable surplus in general government finances. According to this strategy, the central

government finances should be in balance, in national account terms, at the end of the electoral period in 2007. To achieve this target the government approved multi-annual spending limits for 2004-2007 in May 2003. Based on these limits, total expenditure in central government may increase by nearly one per cent a year in real terms on average in 2004-2007. Expenditure control is deemed necessary as tax revenues will fall due to tax cuts and increased tax competition in the near future. Furthermore, concerning government debt, the programme regards it essential that the general government gross debt will be reduced in view of the future expenditure pressures stemming from ageing population.

Table 2. Comparison of key public finance figures

% of GDP		2003	2004	2005	2006	2007
Gen. Gov. budget balance	SP 2003	2.3	1.7	2.1	2.1	2.2
	SP 2002	2.7	2.1	2.6	2.8	
	COM	2.4	1.7	1.9		
Total Expenditures	SP 2003	48.7	48.7	48.7	48.8	48.8
	SP 2002	47.1	46.9	46.4	46.1	
	COM	50.9	51.0	50.1		
Total Revenues	SP 2003	51.0	50.4	50.8	50.8	51.0
	SP 2002	49.9	49.1	49.0	48.9	
	COM	53.4	52.7	52.0		
Government gross debt	SP 2003	45.1	44.7	44.9	45.0	44.6
	SP 2002	41.9	41.9	41.4	40.7	
	COM	44.6	44.5	44.3		

SP 2003 = Stability Programme update of November 2003
 SP 2002 = Stability Programme update of November 2002
 COM = Commission Autumn 2003 forecast

The latest programme update estimates the general government surplus to ease from an estimated 2.3% of GDP in 2003 to 2.2% in 2007. Compared with the previous update, the surplus estimates for 2003-2006 is seen to be lower by 0.4 – 0.7 percentage points. The current update extends the programme period from 2006 to 2007, and the surplus is projected to rise from 2.1% of GDP in 2006 to 2.2% by the end of 2007.

Regarding government levels, the 2003 programme foresees a *central* government deficit of 0.1% of GDP in 2003¹¹, down from a surplus of 1.4% in 2002, and a further decrease into deficit of 0.7% in 2004. The financial position is seen to stay in deficit in 2005-07. Compared with previous programme the estimates for central government finances have been lowered for all years. The weakening of financial position is mainly attributed to cyclical reasons and increased spending items put forward in the new government's programme. In addition, direct (income) and indirect (alcohol) tax cuts will weigh on the financial balance in 2004. Also corporate and capital tax reform, taking effect from the beginning of 2005, will initially lower tax receipts by more than € 0.3 bn i.e. 0.2% of GDP. However, in the medium-term the reform is seen to raise tax revenue. The projected net lending of *local governments* has also been revised downwards for 2003 and 2004 and upwards for 2005-2006. While local government finances are expected to show a small deficit throughout the programme period, the deficit is envisaged to shrink to 0.1% of GDP in 2007. Even though the financial situation of local governments will continue to be tight over the coming years due to

¹¹ Central government budget balance has shown a surplus between 2000 and 2002.

moderation in tax receipts and rising spending, the local governments are required to keep their finances at least broadly in balance during the three-year planning period. Legislation adopted in 2001 requires local governments to aim from 2002 onwards for budgetary balance in the medium-term. Finally, the estimated surplus of *social security institutions* has been kept virtually unchanged from the 2002 programme; the surplus is seen to be 3.2% of GDP at the end of the programme period.

In May 2003, the new government introduced multi-annual spending limits for 2004-2007. According to the new guidelines, ¾ of budget appropriations are covered by the limits, excluded are cyclically sensitive expenditures and spending items that are not justified to be committed over the entire electoral term. Based on these limits real expenditure may rise by nearly one per cent a year in real terms on average in 2004-2007. The 2004 budget proposal shows that central government finances abide the limit set by the spending ceilings. The spending limits are the primary instrument of the Finnish government to maintain budgetary discipline.

The programme includes calculations of the structural balance of government finances. The figures presented in the Finnish programme are fairly close to the estimates by the Commission services, based on the Commission Autumn forecast. Estimated potential growth rates of GDP differ only marginally from each other. For 2005-07, the Commission estimates of potential GDP growth are more optimistic than those in the programme. Also the Commission services estimates for potential output and cyclically-adjusted balance (CAB), using the assumptions of the programme for GDP growth, government balance, unemployment rate and employment growth are broadly in line with the calculations of the programme.

Table 3. Cyclically-adjusted public finances

	Stability Programme ¹⁾					Stability Programme ²⁾		Autumn Forecast ^{*)}			
	Budget Balance	Primary balance	GDP growth	PF Potential growth	CAB	PF Potential growth	CAB	Budget Balance	GDP Growth	PF Potential growth**	CAB
2002	4.2	4.4	2.2	3.2	4.3	3.1	3.8	4.2	2.2	3.1	3.8
2003	2.3	2.4	1.4	2.6	3.0	2.7	2.7	2.4	1.5	2.6	2.8
2004	1.7	1.6	2.7	2.5	2.4	2.6	2.0	1.7	2.5	2.5	2.1
2005	2.1	1.8	2.5	2.1	2.4	2.4	2.4	1.9	2.7	2.4	2.0
2006	2.1	1.8	2.4	2.0	2.3	2.3	2.3			2.3	
2007	2.2	1.8	2.4	2.0	2.2	2.2	2.2			2.2	

1) The programme presents structural balances calculated using the PF-method.
2) Presents PF-method estimates by the Commission services based on the SP data.
*) Commission services Autumn forecast 2003.
**) Commission estimates for 2006-2007 based on the data of the Autumn forecast 2003.

Between 2003-04, the nominal balance is forecast to fall at similar pace as the cyclically-adjusted balance by 0.6 percentage points of GDP. The nominal surplus is seen to edge up by 0.4 percentage points, whereas the CAB is estimated to be

unchanged at some 2½ % in 2005. While the nominal surplus is projected to improve slightly in 2007, the CAB is estimated fall marginally. In the absence of any known one-off budgetary measures, the CAB can be taken as being equal to the underlying budget balance. The primary surplus is seen to moderate from 2.4% of GDP in 2003 to 1.8% in 2007 due to increasing negative net interest payments.

According to this analysis, the projected decline in the CAB by over ½ percentage points of GDP between 2003-05, clearly revealed in both the programme and the Commission estimates, seems to come at a time when the economy should be gathering momentum and the negative output gap is narrowing, suggesting a pro-cyclical stance of fiscal policy. Still, with underlying surpluses of at least 2% of GDP (apart from 1.7% of GDP in 2004) Finland is expected to continue to satisfy the requirements of the SGP over the whole programme period.

3.2 Implementation of the previous programme update

Output growth accelerated in 2002, as expected in the stability programme update of November 2002, posting a fair 2.2%, but falling short of an average rate of growth of well over 4% during the second half of the 1990`s. This was mainly due to a rebound of external demand. General government finances showed a strong surplus of 4.2% of GDP¹², i.e. 0.4 percentage points higher than projected in the 2002 update of the stability programme, owing to slightly higher tax revenues and higher social security contributions. In spite of a higher than expected surplus, the debt to GDP ratio turned out to be slightly higher than projected in the previous programme, by 0.2 percentage points of GDP at 42.7% of GDP, due mainly to net accumulation of financial assets and the ongoing diversification of social security institutions' assets away from domestic government bonds. A comparison with the previous update is given in table 2 of this note.

GDP in 2003 is expected to have grown by some 1½%, less than half the estimate in the previous update. Final domestic demand is expected to have maintained its growth-supportive role, although investment activity is estimated to have decreased. Also net exports seem to have made a positive growth contribution, albeit less than expected. Owing partly to the exceptionally high corporate and capital tax revenues of 2000-01 returning to normal and partly by cyclical factors and increased spending, the general government surplus is estimated to have declined by almost 2 percentage points of GDP in 2003. Accordingly, the expected surplus of 2.3% of GDP is below the target set in the previous programme by 0.4 pp. of GDP. The government gross debt ratio is estimated to have risen to 45.1%. This is some 3.2 percentage points of GDP higher than targeted in the previous programme and is mainly due to a removal of central government debt held by the State Treasury itself from the Treasury's balance sheet, and also to lower than expected nominal GDP.

The GDP growth estimate of 2.7% for 2004 is virtually unchanged from the previous programme, although growth seems to lean more towards the external demand component. The government surplus, on the other hand, is estimated at 1.7% of GDP,

¹² General government surplus reached 7.0% of GDP in 2000 owing mainly to buoyant corporate and capital tax revenues.

i.e. 0.4 percentage points lower than previously targeted. This is due to lower tax revenues than year ago expected. Moreover, debt should increase to 44.7% of GDP, 2.9 percentage points above the target of the previous programme, owing partly to a lower primary surplus and partly to technical change in the statistics. In 2005, at 2.5%, GDP growth is expected to be in line with last programme's projection. The general government balance in 2005 is estimated to fall short of the target of the previous programme by over ½ percentage point of GDP, due mostly to rising deficit in central government finances. It should still reach a surplus of 2.0% of GDP. At 44.9% of GDP, the general government gross debt ratio is projected to be 3.5 percentage points higher than the target set in the previous programme.

3.3 Public finances in 2004

The programme projects the general government surplus to continue to fall, reaching 1.7% of GDP in 2004. This is mostly due to tax revenues falling by 0.6 percentage points of GDP from 2003. The government has proposed income tax cuts worth of € 750 million, i.e. 0.5% of GDP and taxes on alcohol beverages will be lowered by 33% on average. This will result in tax revenue loss of € 500 million or 0.4% of GDP. Social security contributions are expected to remain unchanged in relation GDP, in spite of implemented cuts in social security contributions.

The programme expects general government expenditure to be unchanged at 48.7% of GDP from 2003. However, according to the update, central government expenditure in the 2004 budget proposal, excluding interest payments, is up by 4% in real terms from 2003. Half of the increase derives from appropriations increases forced by current legislation and decisions made by the previous government, and the other half from the spending increases included in the new government's programme and compensations payable to other government levels due to income tax cuts.

The government has adopted a programme for the development of welfare services and income transfers, where available additional resources will be distributed effectively to promote job creation and economy's growth potential. In order to attain its employment objectives, the government will put forward a package of measures targeted to support entrepreneurship and employment. These measures comprise, inter alia, education policy, R&D investments and the reform of labour policy. In the light of the high unemployment level, the government will increase active labour market measures and introduce a cross-administrative employment programme targeted at breaking the hard core of unemployment. This will be achieved by setting up, inter alia, labour service centres. Also means testing for labour market support will be eased and subsistence allowances will be increased to combat employment and poverty traps.

In local government level growth in consumption expenditure is seen to abate by 1.5% in real terms and investment expenses are expected to fall. Expenditure in social security funds is projected to grow faster than GDP. General government debt is forecast to fall by 0.3 percentage points to 44.7% of GDP in 2004, on account of a higher nominal GDP.

3.4 Targets and adjustment in 2005 and beyond

The updated programme projects a general government surplus of 2.1% of GDP in 2005. From thereon, the surplus should edge up to 2.2% by 2007, owing to expenditure restraint, whereas revenues in relation to GDP are forecast to revert to 51.0% of GDP, same as in 2003. The rise in the surplus in 2005 will mainly be due to improvement in local government finances and higher in-take in social security funds (by some 0.2 percentage points of GDP in both cases) from 2004. The financial position of the central government is envisaged to weaken marginally in 2005-06, reaching a deficit of 0.9% of GDP at the end of the programme period. In addition, social security contributions to pension funds are set to rise on the back of a reform designed to speed up the pre-funding of the earnings-related pension fund between 2003 and 2013.

The programme assumes no further income tax relief from 2005 onwards. In addition to the erosion of the tax base in 2004 stemming from tax cuts on income and alcohol, tax competition is seen to increase owing to economic integration. Therefore, tax revenue from the corporate sector is assumed to decline over the programme period and also due to the reform of corporate and capital taxation. Following a government decision on 14 November 2003, corporate and capital income taxation will be reformed from the beginning of 2005. In order to safeguard the international competitiveness of the tax system, corporate tax rate will be lowered by 3 percentage points to 26% and capital income tax rate by one percentage point to 28%. In the light of the ageing of population, the reform includes measures to facilitate the transfer of business between generations. At the moment it is difficult to assess the reform's impact on revenues, with mechanical calculations suggesting that tax revenue will decrease by over € 300 million i.e. 0.2% of GDP. However, changes in tax receipts will affect only the central government, as local governments will be fully compensated.

Table 4. Revenue and Expenditure Ratios

% of GDP	ESA code	Year 2003	Year 2004	Year 2005	Year 2006	Year 2007	Chg.* 03-07
Components of revenues							
1.1. Taxes	D2+D5	32.1	31.5	31.6	31.5	31.4	-0.7
1.2. Social contributions	D61	12.4	12.4	12.5	12.7	12.8	0.4
1.3. Other		6.5	6.5	6.6	6.7	6.7	0.2
1. Total receipts	ESA	51.0	50.4	50.8	50.8	51.0	0.0
Components of expenditures							
2.1. Collective consumption	P32	8.0	8.0	8.1	8.1	8.1	0.1
2.2. Social transfers	D63, D62	17.2	17.3	17.3	17.3	17.3	0.1
2.3. Interest payments	D41	2.1	2.0	1.9	2.0	2.1	0.0
2.4. Subsidies	D3	1.4	1.4	1.4	1.3	1.3	-0.1
2.5. Gross fixed capital formation	P51	2.7	2.5	2.4	2.4	2.3	-0.4
2.6. Other		17.3	17.5	17.6	17.7	17.7	0.4
2. Total expenditures	ESA	48.7	48.7	48.7	48.8	48.8	0.1

* = percentage points change (calculated from non-rounded values)

According to the programme, the government is expected to continue a strategy of expenditure restraint over the period 2005-07. Even though the expenditure in relation to GDP is seen to rise marginally. Taking into account the new spending limits, the government will need to finance each additional spending item either by expenditure cuts elsewhere or by improving the efficiency of the central government functions in order to achieve this goal. Strict adherence to central government expenditure ceilings is important also in view of the age-related expenditure pressures, since local governments seem to remain in deficit¹³ drifting, thus, away from the target set in 2001 by legislation requiring local government finances to remain close to balance within a three-year period.

3.5 Sensitivity analysis

The programme includes two sensitivity scenarios for developments of public finances: low and high GDP growth scenarios (+/- 1 percentage points annual deviation from the baseline). General government finances are expected to post a fairly noticeable surplus even in the low growth scenario and general government gross debt would still remain significantly below the 60% threshold. The Commission estimates that slower trend GDP growth by one percentage point p.a. leads to a decrease in general government net lending by almost 0.7 percentage points¹⁴.

Using the baseline macroeconomic scenario of the programme, the Commission services have carried out a sensitivity analysis allowing for a change in potential output growth over the programme period implying, that the underlying government balance is also allowed to change. The results confirm the picture given by the sensitivity analysis of the programme. The general government financial position stands a good chance to comply with the requirement of “close to balance or in surplus” in the medium-term, since even in the worse-case scenario; the cyclically-adjusted balance would reach some 0.9 %¹⁵. To conclude, the projected budget surpluses in the 2003 programme update appear more than sufficient to provide the necessary safety margin against breaching the 3% reference value of the SGP in the event of normal cyclical fluctuations.

3.6 Debt path

The general government gross debt ratio is forecast to remain well below 60% of GDP and on a downward path virtually throughout the programme period. The programme projects debt to fall from an estimated 45.1% of GDP in 2003 to 44.6% by 2007. Compared with the previous programme update, the current programme projects the debt to GDP ratio to be about 3.2 percentage points higher for 2003, due to removal of repo portfolio or central government debt held by the State Treasury itself from the Treasury’s balance sheet. This was done, because the repo portfolio was no longer required for government debt servicing. Consequently, the level of debt to GDP ratio has risen over the remaining years of the programme. From 2004 onwards, the gross debt ratio is estimated to increase slightly and in 2007 ease modestly to 44.6% of GDP.

¹³ Deficits are projected for 2003-07 in local government finances.

¹⁴ Commission services estimate it at 0.66.

¹⁵ In the worse-case scenario, the cyclically-adjusted budgetary surplus would go down to some 0.9% of GDP in 2004, from where it would rise to about 1.0% by 2007.

The previous programme projected the debt ratio to GDP to decline by 1.2 percentage points between 2003-06, compared with the current estimated decline of a mere 0.1 percentage point. The government has become clearly more pessimistic over the development of the debt ratio. The decline in the gross debt ratio is slowed down mainly by deficits in both local and central government during the programme period and partly by financial transactions, in particular the ongoing diversification of social security institutions' assets away from central government bonds. It cannot be excluded, however, given the amount of government debt held by the social security sector, that the portfolio shifts of the pension funds might be faster than expected in the programme¹⁶, and the fall of the gross debt ratio could slow down even more over the period. Still, the government gross debt ratio should remain below the 60% ceiling for the whole period of the programme under any reasonable scenario. In addition, it appears that the financial assets in the public sector exceed its gross debt owing to the partial pre-funding of pensions.

4 THE QUALITY OF PUBLIC FINANCES

In terms of quality, Finland's public finances appear to be sound. The previous governments have aimed for creating surpluses in central government finances¹⁷ and to reduce the central government debt-to-GDP ratio. The new government appointed in June is continuing in the same direction and has introduced new measures to improve the quality of public finances. Also the challenges in the 2003-05 BEPGs for Finland relate to these issues. In the BEPGs Finland was recommended, to reduce high level of structural unemployment, raise the employment rate of older workers, enhance competition in certain sectors and improve efficiency in public sector. The government has responded to these challenges by implementing and putting forward measures and reforms to improve the functioning of product, capital and labour markets. With the aim of creating a uniform operating environment for business companies, the reform of the Competition Restrictions Act is underway. Productivity action programme, in which each administrative domain draws up a productivity development plan, has been set forth to improve productivity in the central government. The implementation of these programmes will be included in the spending limits and budget proposals starting in 2005-07. The work to reform the national Public Procurement Act is continuing. The government introduced multi-annual spending limits in the beginning of its term to avoid expenditure overruns and to improve the predictability of the central government finances. The government is continuing to finalise the ongoing process of pension reform. Agreement was reached in September 2002 to reform the private sector pension system¹⁸. Moreover, according to the government, a reform of the public

¹⁶ The employment pension funds are assumed to reduce their investments in central government assets by € 1.0 billion in 2002, by € 0.5 billion in 2003 and by € 0.3 billion in 2004 to 2006.

¹⁷ See footnote 10.

¹⁸ Measures include, *inter alia*, an introduction of the flexible retirement age of 62-68, accompanied by higher accrual rates of pension rights for the later years in work; a rise of the part-time pension age from 56 to 58 years, accompanied by a reduced accrual rate of the part-time salary; a gradual abolition of the unemployment pension scheme and the abolition of the individual early (disability) retirement scheme; pension benefits will be calculated on the basis of wages during the whole work career with an improved indexation of wages (a hybrid index with a weight of 80% to a wage index and of 20% to a price index); the annual accrual rate will be 1.5% up to the age of 52 years, 1.9% in the age range of 53 to 62 years,

sector pension system will also be reached within the next year. A reform of the unemployment insurance system was agreed in late 2001. All these measures should help to keep control over expenditure in coming years. Only few reform measures will be introduced as of 1 January 2003 while main reforms should be adopted as of 1 January 2005 and some as late as in 2009. Therefore, phasing-in periods for some of the measures appear to be rather long, implying that the financial benefits of these reforms will largely accrue only after 2010.

As for the more medium-term challenges, the government's key economic objective is to create 100 000 new jobs by the end of the electoral period in 2007 and to raise the employment ratio to 75% of the working age population by 2011. In addition, the government continues to encourage the employment of older workers. In order to attain these objectives, government will put forward measures targeted to support entrepreneurship and employment. These measures comprise, inter alia, education policy, R&D investments and the reform of labour policy. Moreover, unemployment in Finland remains well above the level in other EU Member States, even though the gap is projected to narrow in 2004-07. The programme sets out the government's intentions of cutting further income tax and social security contribution in 2004, to strengthen active labour market measures and to seek greater labour market flexibility¹⁹. Still, it appears that the active labour market measures taken so far, as well as those designed to reduce the tax wedge on labour income may not suffice to reduce the hard core of structural unemployment.

The structural reform measures presented in the programme are clearly a step in the right direction, in particular with respect to improving the longer-term sustainability and quality of public finances overall.

5 SUSTAINABILITY OF PUBLIC FINANCES

5.1 Quantitative indicators

The assessment of the sustainability of Finnish public finances is based on both quantitative and qualitative indicators. The quantitative indicators projects debt and budget balance development according to two different scenarios, to take into account uncertainties over the medium term. The "programme" scenario is calculated on the following basis:

- Macroeconomic assumptions on GDP growth, interest rates and inflation are based on the agreed assumptions used in the EPC;
- The projections for age-related expenditures come from the stability programme, complemented with the Economic Policy Committee harmonised projections.

4.5% in the age range of 63 to 68 years: from the age of 53 onwards the employee pension contribution will be 30% higher than for those under 53; the so-called lifetime coefficient will be introduced as of 2009, i.e. a mechanism that adjusts the level of the pension to the expected lifetime.

¹⁹ E.g. taxes on labour have been reduced, the quality of ALMPs will be improved, labour service centres will be established and efforts to prevent exclusion from the labour market will be intensified.

- The projections for government revenues come from the programme. They are kept constant at the (cyclically adjusted) level in 2007.
- The starting point for gross debt and the primary balance are the 2007 levels reported in the programme.
- The impact of the forthcoming pension reform foreseen in the programme is assumed to materialize.

A “2003 position” scenario is based on the budgetary data for 2003 in the programme. Debt levels are extrapolated from 2008 to 2050 assuming that no budgetary consolidation is achieved, i.e. the cyclically adjusted primary balance in 2008 remains the same as the 2003 level and no stock-flows operations take place.

Table 5 presents the debt and the budget balance development according to the two different scenarios. Projections are based on national projections on pensions and other social expenditures. Health care, education and unemployment benefits projections rely on the EPC common exercise. Overall, age-related expenditure is foreseen to increase by 4.9% of GDP between 2008 and 2050. Compared with last year assessment, savings due to a reduction of education expenditures have been included.

Table 5. Quantitative indicators of the sustainability of public finances

Long term sustainability: summary results
Finland

Main assumptions - baseline scenario (as % GDP)	2008	2010	2020	2030	2040	2050	changes
<i>Total age-related spending</i>	25,6	25,8	27,8	30,1	30,6	30,5	4,9
Pensions	11,6	11,8	13,3	14,7	14,6	14,5	2,9
Health care	4,8	4,9	5,2	5,6	5,7	5,8	1,0
Education ¹	5,8	5,7	5,7	5,6	5,5	5,4	-0,4
Unemployment benefits ¹	1,5	1,5	1,5	1,5	1,5	1,5	0,0
Others	1,8	1,9	2,2	2,7	3,3	3,3	1,5
<i>Total non age-related spending*</i>	21,3						
<i>Total revenues</i>	51,0	51,0	51,0	51,0	51,0	51,0	0,0

¹ Based on the EPC projections

* constant

Results (as % GDP)	2008	2010	2020	2030	2040	2050	changes
<i>Programme scenario</i>							
Debt	40,9	34,0	10,3	4,7	12,4	23,7	-17,1
Net borrowing	2,0	2,0	1,3	-0,6	-1,4	-2,0	-4,0
<i>2003 scenario</i>							
Debt	23,6	14,6	-22,5	-44,8	-57,7	-71,0	-94,6
Net borrowing	3,6	3,8	3,8	2,8	3,1	3,9	0,3

Tax gaps	T1*	T3**
Programme scenario	0,2	-1,8
2003 situation scenario	-1,1	-2,8

* it expresses the constant difference between projected revenues and the revenues required to reach in 2050 the same debt to GDP ratio as the close to balance position holds for the whole projection period. P.m. debt to GDP at the end of the period: 9,3%

** It indicates the change in tax revenues as a share of GDP that guarantees the respect of the intertemporal budget constraint of the government, i.e., that equates the actualized flow of revenues and expenses over an infinite horizon.

It is possible to verify whether the projected level of debt respects the requirement to stay below 60% of GDP reference value for public debt at all times. Failure to do so would *a priori* indicate that there may be a risk of budgetary imbalances emerging in light of ageing population and that measures may be required to place public finances on a more sustainable footing. However, it warrants attention that Finland has large financial assets in pension funds which can be used to meet future expenditure needs. According to information provided in the updated programme, the market value of these assets is close to 51% of GDP. Therefore a large gap between the gross and net debt arises, with the latter already on the positive side.

According to the quantitative indicators run on the basis of the gross debt, Finland is on a sustainable path. The impact of the forthcoming pension reform on participation rates among elderly workers and the sustained budgetary surplus will allow a reduction of the gross debt to GDP ratio. No sustainability gap therefore arises. The SGP requirements can be respected all times even with a less tight fiscal policy. According to the T1 indicator, there is no gap in the baseline scenario and a negative gap of 1.1% of GDP arises in the “2003 scenario”.

5.2 Additional qualitative features

As underlined in the EPC report on “The impact of ageing populations on public finances: overview of analysis carried out at EU level and proposals for a future work programme”²⁰ (October 2003), several qualitative factors should be taken on board to avoid a mechanistic interpretation of the quantitative indicators. On the positive side, initial gross debt to GDP ratio is already low and Finnish authorities have a strategy that aim at run down public debt before the impact of ageing takes place. Also, the pension system is largely pre-funded. This strategy puts Finland on a favourable position to meet the budgetary cost of ageing.

However, two factors warrant attention: first, debt projections rely on very high tax burden (43.5%) compared with EU average. Even if each Member State can decide over its optimal level of taxation, the expected Finnish one will appear higher relative to other industrialised countries. Pressures to reduce the level of taxation cannot be excluded in the future. Second, pension projections show a rather big difference with EPC projections at the end of the period (i.e. after 2030): while the latter shows an increase of pension expenditure by 1 p.p. of GDP between 2030 and 2050, the former projects a saving equal to 0.2% of GDP as a result of increased retirement age due to the forthcoming reform.

5.3 Overall assessment

The Commission considers that, on the basis of the current policies, Finland appears to be in a relative good position to meet the budgetary costs associated with ageing populations. This is largely due to the sustained running of a budget surplus which is leading to a fast pace of debt reduction and the impact in the long term of the forthcoming pension reform. The budgetary strategy outlined in the programme is compatible with improving the sustainability of public finances.

²⁰ Available at http://europa.eu.int/comm/economy_finance/epc/documents/2003/pensionmaster_en.pdf

6 OVERALL ASSESSMENT OF COMPLIANCE WITH THE SGP

The updated programme foresees a decline in the general government surplus from 4.2% of GDP in 2002 to 2.1% in 2005, due to a “normalisation” of corporate and capital tax revenues, stimulatory fiscal policy measures and various tax cuts. In subsequent years, the surplus is expected to remain virtually unchanged, at 2.2% of GDP by 2007. Overall, the fall in the surplus ratio is caused by a weakening of central government finances, which are estimated to slip into deficit as from 2003 and stay there until the end of the programme period, showing a deficit of 0.9% in relation to GDP in 2007. Furthermore, the local government financial balance is seen to remain in deficit throughout the programme period. Consequently, according to the programme, the general government financial surplus in 2003-07 rests solely on the surplus of the social security funds and, in particular, on that of the earnings-related pension funds preparing for financial pressures stemming from an ageing population. Despite the envisaged deficit in central and local government finances, the general government surplus is estimated at above 2% of GDP, except in 2004 (1.7%), for the whole programme period.

General government debt is forecast to decline throughout the programme period, apart from 2005-06, with the fall amounting to 0.5 percentage points between 2003 and 2007. Eventually, the debt ratio is expected at 44.6% of GDP in 2007, remaining well below the 60% of GDP reference value in any reasonable growth scenario. All in all, the projected path of the government balance both in nominal and underlying terms and of the government debt confirms that public finances in Finland continue to fully respect the requirements of the Stability and Growth Pact during the programme period.

ANNEX 1 – SUMMARY TABLES FROM THE 2003 UPDATED STABILITY PROGRAMME

Table 1. Growth and associated factors

	ESA Code	Year 2002	Year ²¹ 2003	Year 2004	Year ²² 2005	Year 2006	Year 2007
GDP growth at constant market prices (7+8+9)	B1g	2.2	1.4	2.7	2.5	2.4	2.4
GDP level at current market prices	B1g	139.7	141.9	146.2	151.3	156.7	162.3
GDP deflator		1.1	0.1	0.3	1.0	1.2	1.2
CPI change		1.6	1.0	0.7	1.3	1.8	1.8
Employment growth²³		0.2	-0.2	0.3	0.3	0.2	0.2
Labour productivity growth²⁴		2.0	1.6	2.4	2.2	2.2	2.2
Sources of growth: percentage changes at constant prices							
1. Private consumption expenditure	P3	1.5	3.2	2.6	2.0	1.7	1.7
2. Government consumption expenditure	P3	4.0	2.1	1.5	1.4	1.3	1.1
3. Gross fixed capital formation	P51	-4.0	-4.0	1.1	0.7	1.1	1.1
4. Changes in inventories and net acquisition of valuables as a % of GDP	P52+ P53	-0.2	0.0	0.0	0.0	0.0	0.0
5. Exports of goods and services	P6	4.9	1.6	5.1	5.1	5.0	5.0
6. Imports of goods and services	P7	1.3	1.5	4.0	3.7	3.6	3.6
Contribution to GDP growth							
7. Final domestic demand (1+2+3)		0.8	1.3	1.8	1.4	1.3	1.3
8. Change in inventories and net acquisition of valuables	P52+ P53	-0.2	0.0	0.0	0.0	0.0	0.0
9. External balance of goods and services (5-6)	B11	1.6	0.2	0.9	1.0	1.1	1.1
Basic assumptions							
Short-term interest rate²⁵ (annual average)		3.3	2.3	2.3	3.2	n.a	n.a
Long-term interest rate (annual average)		4.9	4.1	4.4	4.8	n.a	n.a
USD/€ exchange rate (annual average)		1.1	0.9	0.9	0.9	n.a	n.a
World excluding EU, GDP growth		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
EU-15 GDP growth		1.1	0.8	2.0	2.4	n.a	n.a
Growth of relevant foreign markets		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
World import volumes, excluding EU		3.2	6.3	8.3	8.6	n.a	n.a
Oil prices		25.0	28.3	25.6	24.1	n.a	n.a

²¹ Forecasts

²² Trend values or period averages

²³ National accounts definition

²⁴ Growth of GDP at market prices per person employed at constant prices

²⁵ Purely technical assumptions

Table 2. General government budgetary developments

% of GDP	ESA code	2002	2003	2004	2005	2006	2007
Net lending (B9) by sub-sectors							
1. General government	S13	4.2	2.3	1.7	2.1	2.1	2.2
2. Central government	S1311	1.4	-0.1	-0.7	-0.8	-0.9	-0.9
3. State government	S1312						
4. Local government	S1313	-0.3	-0.5	-0.4	-0.2	-0.2	-0.1
5. Social security funds	S1314	3.0	2.8	2.8	3.0	3.2	3.2
General government (S13)							
6. Total receipts	ESA	51.9	51.0	50.4	50.8	50.8	51.0
7. Total expenditures	ESA	47.7	48.7	48.7	48.7	48.8	48.8
8. Budget balance	B9	4.2	2.3	1.7	2.1	2.1	2.2
9. Net interest payments		0.2	0.1	-0.1	-0.3	-0.3	-0.4
10. Primary balance		4.4	2.4	1.6	1.8	1.8	1.8
Components of revenues							
11. Taxes	D2+D5	33.1	32.1	31.5	31.6	31.5	31.4
12. Social contributions	D61	12.4	12.4	12.4	12.5	12.7	12.8
13. Other		6.5	6.5	6.5	6.6	6.7	6.7
14. Total receipts	ESA	51.9	51.0	50.4	50.8	50.8	51.0
Components of expenditures							
15. Collective consumption	P32	7.6	8.0	8.0	8.1	8.1	8.1
16. Social transfers	D63, D62	16.8	17.2	17.3	17.3	17.3	17.3
17. Interest payments	D41	2.2	2.1	2.0	1.9	2.0	2.1
18. Subsidies	D3	1.4	1.4	1.4	1.4	1.3	1.3
19. Gross fixed capital formation	P51	2.9	2.7	2.5	2.4	2.4	2.3
20. Other		16.7	17.3	17.5	17.6	17.7	17.7
21. Total expenditures	ESA	47.7	48.7	48.7	48.7	48.8	48.8

Table 3. General government debt developments

% of GDP	ESA code	2002	2003	2004	2005	2006	2007
Gross debt level		42.7	45.1	44.7	44.9	45.0	44.6
Change in gross debt		-1.3	2.4	-0.3	0.1	0.1	-0.3
Contributions to change in gross debt							
Primary balance		-4.4	-2.4	-1.6	-1.8	-1.8	-1.8
Interest payments	D41	0.2	0.1	-0.1	-0.3	-0.3	-0.4
Nominal GDP growth	B1g	-1.4	-0.7	-1.4	-1.5	-1.6	-1.6
Stock-flow adjustment		4.3	5.4	2.7	3.7	3.8	3.5
<i>Of which: Privatisation receipts</i>		-0.9	-0.3	-0.3	-0.3	-0.3	-0.3
<i>p.m. implicit interest rate on debt</i>		5.2	4.7	4.4	4.3	4.5	4.7

Table 4. Cyclical developments²⁶

% of GDP	ESA Code	2002	2003	2004	2005	2006	2007
1. GDP growth at constant prices	B1g	2.2	1.4	2.7	2.5	2.4	2.4
2. Actual balance	B9	4.2	2.3	1.7	2.1	2.1	2.2
3. Interest payments	D41	2.2	2.1	2.0	1.9	2.0	2.1
4. Potential GDP growth ²⁷		3.2	2.6	2.5	2.1	2.0	2.0
5. Output gap ²⁸		-0.2	-1.3	-1.1	-0.7	-0.4	0.0
6. Cyclical budgetary component		-0.1	-0.8	-0.7	-0.4	-0.2	0.0
7. Cyclically-adjusted balance (2-6)		4.3	3.0	2.4	2.4	2.3	2.2
8. Cyclically-adjusted primary balance (7-3)		6.5	5.1	4.3	4.3	4.3	4.3

Table 5. Divergence from previous update

% of GDP	ESA Code	2002	2003	2004	2005	2006	2007
GDP growth	B1g						
previous update		1.6	2.8	2.6	2.5	2.4	
latest update		2.2	1.4	2.7	2.5	2.4	2.4
Difference		0.6	-1.4	0.1	0.0	0.0	
Actual budget balance	B9						
previous update		3.8	2.7	2.1	2.6	2.8	
latest update		4.2	2.3	1.7	2.1	2.1	2.2
Difference		0.4	-0.4	-0.4	-0.5	-0.7	
Gross debt levels							
previous update		42.5	41.9	41.9	41.4	40.7	
latest update		42.7	45.1	44.7	44.9	45.0	44.6
Difference		0.2	3.2	2.7	3.5	4.3	

Table 6. Long-term sustainability of public finances²⁹

% of GDP	2000	2010	2020	2030	2040	2050
Total expenditure	46.7	48.1	50.3	53.4	55.5	57.7
Old age pensions ³⁰	10.7	11.8	13.3	14.7	14.6	14.5
Health care (including care for the elderly)	6.2	6.8	7.4	8.3	9.0	9.1
Interest payments	2.8	2.2	2.5	3.3	4.8	7.0
Total revenues	53.7	50.6	51.7	51.9	51.9	51.9
<i>of which: from pension contributions</i>	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Assumptions						
Labour productivity growth	2.8	2.2	1.8	1.8	1.8	1.8
Real GDP growth	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total participation rates (aged 20-64)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Unemployment rate	9.8	7.0	7.0	7.0	7.0	7.0

²⁶ Member States can fill in lines 4-8 using either own figures or Commission figures.

²⁷ Trend GDP, % change.

²⁸ Deviation from GDP trend, % change.

²⁹ Information in this table, if provided, should be updated at least every 3 years.

³⁰ Employment pensions, which do not include central government pensions, which amounted to 1.8% of GDP in 2000.