COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 2.2.2005
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Recommendation for a

COUNCIL OPINION

in accordance with the third paragraph of Art. 5 of Council Regulation (EC) No 1466/97 of 7 July 1997

On the updated stability programme of Finland, 2004-2008

(presented by the Commission)

EXPLANATORY MEMORANDUM

Council Regulation (EC) No. 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1] stipulates that participating Member States, that is, those which have adopted the single currency, had to submit stability programmes to the Council and the Commission by 1 March 1999. In accordance with Article 5 of this Regulation, the Council had to examine each stability programme based on assessments prepared by the Commission and the Committee set up by Article 114 of the Treaty (the Economic and Financial Committee). On the basis of a recommendation from the Commission and after having consulted the Economic and Financial Committee, the Council delivered an opinion, following its examination of the programme. According to the Regulation, Member States need to submit annual updates of their stability programmes, which may also be examined by the Council in accordance with these same procedures.

The first stability programme of Finland, covering the period 1998-2002, was submitted on 7 September 1998 and assessed by the Council on 12 October 1998. Updates were presented every following year. Finland submitted the most recent update of its stability programme on 2 December 2004. The Commission services have carried out a technical evaluation of this update, taking into account the results of the Commission services Autumn 2004 economic forecasts, and having regard to the code of conduct[2], the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances, the recommendations in the broad economic policy guidelines for the period 2003-2005 and the principles laid down in the Communication from the Commission to the Council and the European Parliament of 27 November 2002 on strengthening the coordination of budgetary policies[3]. This evaluation warrants the following assessment:

- On 2 December 2004 the government of Finland approved the updated stability programme and, as with previous updates, submitted it to parliament for information. The update of the stability programme covers the period from 2004 to 2008. The programme broadly complies with the code of conduct, as some of the basic assumptions variables are missing.
- The macroeconomic scenario presented in the programme sees the economy growing above 3% in 2004 on the back of robust domestic demand, easing somewhat to a growth rate of 2.8% in 2005. Projected average growth of about 2.5% throughout the programme period seems to be on the cautious side. The short-term forecast is somewhat below the Commission services Autumn 2004 forecast; and also the medium-term projection based on potential output presented in the programme is below the growth potential as estimated by the Commission services.
- The government's key budgetary policy objective is to keep central and local government finances close to balance. With social security funds regularly in surplus, the general government balance is to show an annual surplus close to 2% of GDP. According to this

1 OJ L209, 2.8.1997. All the documents referred to in this text can be found at the following website: http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm.

2 Revised Opinion of the Economic and Financial Committee on the content and format of stability and convergence programmes, endorsed by the ECOFIN Council on 10.7.2001.

3 COM(2002) 668 final, 27.11.2002.

policy, balance in central government finances, in national account terms, should be restored at the end of the electoral period in 2007. To help to achieve this target the government in May 2003 approved annual spending limits for the period 2004-2007. Based on these limits, total expenditure of the central government is allowed to increase by nearly 1 per cent a year in real terms on average over that period. As most of the expenditure increase has been frontloaded to 2004, there is less room for manoeuvre within the ceilings in the latter part of the electoral period. Compared with the previous update, the projections for the general government surplus from 2004 to 2007 are virtually unchanged.

– Although Finland is set to maintain a favourable public sector surplus, the budgetary outcome could be worse than projected as the baseline budgetary trend presented in the update only partially includes the tax cuts of € 1.7 billion i.e. 1.2% of GDP that supplement the two-and-half-year comprehensive wage agreement concluded at the end of November 2004. As there are no announced plans to decrease spending in 2005-2007, the central government deficit would be higher between 2005 and 2007 than cited in the programme, unless revenue-raising measures are introduced, thereby also lowering the surplus in general government finances. The government estimates that the wage-agreement-cum-tax-cuts will lower the general government surplus by 0.3 percentage points to about 1.9% of GDP in 2007. However, the government expects that the package will strengthen dynamism in the economy by improving the growth potential and job creation and in this way raise the revenue-raising capacity. In view of this risk assessment, the budgetary stance in the programme is sufficient to maintain the Stability and Growth Pact's medium-term objective of a position of close-to-balance for 2004-2008. It also provides a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations for 2004-2008.

– The general government gross debt ratio is forecast to remain well below 60% of GDP and be on a downward path throughout the programme period. The current programme projects the debt ratio to fall from an estimated 44.6% of GDP in 2004 to about 41% by 2008. Compared with the previous programme update, the current programme projects the debt-to-GDP ratio to be markedly lower from 2005 onwards due to higher nominal GDP growth, a lower level of central government borrowing, lower interest payments and higher tax receipts. The previous programme projected the debt-to-GDP ratio to remain virtually stable at below 45% of GDP in 2004-2007, compared with the current estimated decline of almost three percentage points.

– The programme reviews the government's structural reform programme, which focuses on improving public sector sustainability by the pension reform taking effect in 2005. The reform, following up on earlier measures, is projected to raise the exit age from the labour force by three years to 62-63 years. It also outlines further measures to lower the persistently high structural unemployment. The collective wage contract agreed in late November 2004 supplemented with tax cuts is expected to foster dynamism in the economy and strengthen job creation. The measures taken and put forward by the government can indeed be expected to raise potential growth and strengthen further the sustainability of public finances.

– Finland appears to be in a favourable position with regard to long-term sustainability of the public finances, in spite of important projected budgetary costs of an ageing population. The strategy outlined in the programme is broad-based and consists of further debt consolidation and structural reforms e.g. further steps of the pension reform and measures aimed at raising the exit age. The structural reforms enacted and planned should have beneficial effects on the public finances.

– Overall, the economic policies outlined in the update are broadly consistent with the country-specific broad economic policy guidelines in the area of public finances. In particular, the multi-annual spending limits introduced in 2003 seem to have worked well in the first year of operation, namely 2004, when the final budgetary spending was below the ceiling and also expenditure in the 2005 budget is within the ceilings. The adherence to the expenditure framework is set to be maintained as it is politically binding.

Based on this assessment, the Commission has adopted the attached recommendation for a Council Opinion on the updated stability programme of Finland and is forwarding it to the Council.

Recommendation for a

COUNCIL OPINION

in accordance with the third paragraph of Art. 5 of Council Regulation (EC) No 1466/97 of 7 July 1997

On the updated stability programme of Finland, 2004-2008

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[4], and in particular Article 5(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On [17 February 2005] the Council examined the updated stability programme of Finland, which covers the period from 2004 to 2008. The programme broadly complies with the data requirements of the revised "code of conduct on the content and format of stability and convergence programmes". Some variables concerning the basic assumptions are missing. Accordingly Finland is invited to achieve full compliance with the data requirements.

(2) The macro-economic scenario underlying the programme envisages real GDP growth to ease from 3.2% in 2004 to 2.4% on average over the rest of the programme period. On the basis of currently available information, this scenario seems to reflect rather cautious growth assumptions. The programme's projections for inflation appear realistic and are in line the Commission services estimates.

(3) With a projected annual surplus averaging 2% of GDP for the general government, the update is set to maintain a comfortable budgetary position throughout the programme period. The surplus is essentially generated in the social security funds, while central government finances, currently in balance, should post small deficits in 2005-07. The aim is to have central government finances back in balance in 2007. To this end, the government has adopted annual spending limits for the period 2004-2007. Compared

4 OJ L209, 2.8.1997, p. 1. The documents referred to in this text can be found at the following website: http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm.

with the previous update, the projections for the general government surplus from 2004 to 2007 are virtually unchanged.

(4) Although Finland is set to maintain a favourable public sector surplus, the budgetary outcome could be worse than projected as the baseline budgetary trend presented in the update only partially includes the tax cuts of € 1.7 billion i.e. 1.2% of GDP that supplement the two-and-half-year comprehensive wage agreement concluded at the end of November 2004. As there are no announced plans to further restrain spending in 2005-07, the central government deficit would be higher between 2005 and 2007 than mentioned in the programme, unless revenue-raising measures are introduced, thereby also lowering the surplus in general government finances. The government estimates that the wage-agreement-cum-tax-cuts will lower the general government surplus by 0.3 percentage points to about 1.9% of GDP in 2007. However, the government expects that the package will strengthen dynamism in the economy by improving the growth potential and job creation and in this way raise the revenue-raising capacity.

(5) In view of this risk assessment, the budgetary stance in the programme is sufficient to maintain the Stability and Growth Pact's medium-term objective of a position of close-to-balance for 2004-2008. It also provides a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations for 2004-2008

(6) The debt ratio is estimated to have reached 44.6% of GDP in 2004, well below the 60% of GDP Treaty reference value. The programme projects the debt ratio to decline by 3.5 percentage points over the programme period.

(7) Finland appears to be in a favourable position with regard to long-term sustainability of the public finances, in spite of important projected budgetary costs of an ageing population. The strategy outlined in the programme is broad-based and consists of further debt consolidation and structural reforms e.g. further steps of the pension reform and measures aimed at raising the exit age. The structural reforms enacted and planned should have beneficial effects on the public finances.

(8) The economic policies outlined in the update are broadly consistent with the country-specific broad economic policy guidelines in the area of public finances. In particular, the multi-annual spending limits introduced in 2003 seem to have worked well in the first year of operation, namely 2004, when the final budgetary spending was below the ceilings and also expenditure as proposed in the 2005 budget is within the ceilings. The adherence to the expenditure framework is set to be maintained as it is politically binding.

Comparison of key macroeconomic and budgetary projections

		2004	2005	2006	2007	2008
Real GDP (% change)	**SP Dec 2004**	**3.2**	**2.8**	**2.4**	**2.2**	**2.0**
	COM Oct 2004	3.0	3.1	2.7	n.a.	n.a.
	SP Nov 2003	*2.7*	*2.5*	*2.4*	*2.4*	*n.a.*
HICP inflation (%)	**SP Dec 2004**	**0.2**	**1.4**	**1.8**	**1.8**	**1.8**
	COM Oct 2004	0.2	1.5	1.7	n.a.	n.a.
	SP Nov 2003	*0.7*	*1.3*	*1.8*	*1.8*	*n.a.*
General government balance (% of GDP)	**SP Dec 2004**	**2.0**	**1.8**	**2.1**	**2.2**	**2.0**
	COM Oct 2004	2.3	2.1	2.2	n.a.	n.a.
	SP Nov 2003	*1.7*	*2.1*	*2.1*	*2.2*	*n.a.*
Primary balance (% of GDP)	**SP Dec 2004**[2]	**3.7**	**3.4**	**3.8**	**3.9**	**3.7**
	COM Oct 2004	4.1	3.9	3.8	n.a.	n.a.
	SP Nov 2003	*3.7*	*4.0*	*4.1*	*4.3*	*n.a.*
Cyclically-adjusted balance (% of GDP)	**SP Dec 2004**[1]	**2.1**	**1.7**	**2.0**	**2.1**	**1.9**
	COM Oct 2004	**2.8**	**2.3**	**2.3**	n.a.	n.a.
	SP Nov 2003[1]	*2.4*	*2.4*	*2.3*	*2.2*	*n.a.*
Government gross debt (% of GDP)	**SP Dec 2004**	**44.6**	**43.4**	**42.5**	**41.7**	**41.1**
	COM Oct 2004	44.8	43.4	42.2	n.a.	n.a.
	SP Nov 2003	*44.7*	*44.9*	*45.0*	*44.6*	*n.a.*

Note:

[1]Commission services calculations on the basis of the information in the programme

[2]The Finnish authorities provide primary balances on the basis of net interest payments rather than gross interest payments. The Commission services have recalculated the figures based on the data given in the programme.

Sources:
Stability programme (SP); Commission services autumn 2004 economic forecasts (COM); Commission services calculations