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FINLAND: MACRO FISCAL ASSESSMENT

AN ANALYSIS OF THE DECEMBER 2008 UPDATE OF THE STABILITY PROGRAMME

The Stability and Growth Pact requires each EU Member State to present an annual update of its medium-term budgetary programme, called "stability programme" for countries that have adopted the euro as their currency and "convergence programme" for those that have not.

The attached technical analysis of the programme, prepared by the staff of, and under the responsibility of, the Directorate-General for Economic and Financial Affairs (DG ECFIN) of the European Commission, was finalised on 18 February 2009. Comments should be sent to Mart Maiväli (mart.maivali@ec.europa.eu). The main aim of the analysis is to assess the realism of the budgetary strategy presented in the programme as well as its compliance with the requirements of the Stability and Growth Pact. However, the analysis also looks at the overall macro-economic performance of the country and highlights relevant policy challenges.

The analysis takes into account (i) the Commission services' January 2009 interim forecast, (ii) the code of conduct ("Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 11 October 2005) and (iii) the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances. Technical issues are explained in an accompanying methodological paper prepared by DG ECFIN.

Based on this technical analysis, the European Commission adopted a recommendation for a Council opinion on the programme on 18 February 2009. The ECOFIN Council adopted its opinion on the programme on 10 March 2009.

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All these documents, as well as the provisions of the Stability and Growth Pact, can be found on the following website:

http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm

1. INTRODUCTION

This document assesses the December 2008 update of Finland's stability programme. It takes into account all currently available information, notably the Commission services' January 2009 interim forecast and the short-term fiscal stimulus measures adopted by Finnish authorities in response to the economic downturn. The programme, which was submitted on 18 December 2008[1], covers the period 2008-2012 and builds on the 2009 budget proposal including its amendment from 20 November 2008 and the 2009-2011 central government spending limits decision. It was approved by the government and presented to the Parliament during the drafting stage without a vote. An addendum to the programme, detailing the measures adopted by the Finnish authorities in response to the economic downturn, was submitted together with the programme on 18 December 2008. The addendum contains a description of the 2009 stimulus measures and specifies their impact on the state budget. The programme projections incorporate all the stimulus measures contained in the addendum.

2. MAIN CHALLENGES IN THE ECONOMIC DOWNTURN AND THE POLICY RESPONSE

Following an above-potential growth rate of 4.2% in 2007, the Finnish economy has rapidly decelerated. In the first half of 2008, annual GDP growth still exceeded 2% as private consumption remained buoyant and exports were sustained by demand from emerging markets. However, growth is forecast by the Commission services to have turned negative already in the last quarter of 2008. In spite of the economy decelerating rapidly over the past year, tax revenues have remained rather firm in 2008 as a whole, albeit also decelerating at the end of the year. This is partly explained by the favourable developments in the labour market, particularly in the first half of 2008, and rapid wage growth upholding income tax revenue. The General government surplus should reach 4½% of GDP in 2008, indicating significant fiscal space for stimulus measures.

The fundamentals of the Finnish economy are sound, posting a significant surplus in the current account and public finances. Annual inflation is also set to drop from the average of 4% reached in 2008 to below 2% in 2009, which is somewhat higher than the euro area average on account of relatively strong wage growth determined by the earlier collective agreements. The domestic financial sector appears strong and will most likely not require a government bail-out. Households will benefit from the strong wage increases, tax cuts and lower inflation, maintaining real disposable income growth in 2009 and 2010 at par with the previous years. Nevertheless, the global economic crisis has cut deeply into output of the country's highly export-oriented industries. Aggravating the downturn, tumbling consumer and business confidence holds back private consumption and investment. Government consumption is expected to increase in 2009, but this would only to a minor extent compensate for the fall in activity of households and enterprises. On the basis of the Commission services' January 2009 interim forecast, growth should be the weakest during 2009, when annual GDP is projected to contract by over 1% on account of a slump in external demand and investment.

Economic activity is predicted to gradually recover in 2010 in line with the projected pick up of demand in the global markets. However, given the expected slow recovery of the main Finnish export markets, growth is predicted to remain below potential in that year and the output gap will widen further. The sizeable current account surplus of the economy would

[1] The English language version was submitted on the same date.

decline, but remain nevertheless in positive territory. The recession would reverse the trend of strong employment creation over the past years. Employment is set to fall by about 1½ % in 2009, but stabilise thereafter. The adverse impact on unemployment will be somewhat smaller as population ageing reduces labour supply.

On the balance, the Finnish economy can be assessed to have rapidly entered bad economic times, expected to prevail into 2010. The government's fiscal policy response to the economic downturn is concentrated on supporting domestic demand through significant tax cuts afforded by the fiscal space and targeted expenditure measures.

3. MACROECONOMIC SCENARIO

As presented in Table I, the programme projects GDP to grow by 0.6% in 2009 and by 1.8% in 2010. These projections are markedly more favourable than the Commission services' January 2009 interim forecast, which expects GDP to contract by 1.2 % in 2009 and grow by only 1.2% in 2010. The difference mainly arises from the programme's more optimistic prospects for export and private consumption growth and, to a lesser degree, investment growth (see Table I). It appears that these discrepancies arise from the relatively early publication of the programme's macro-scenario in November 2008, which could thus not take into account the further deterioration in the global outlook that materialised thereafter. Short term indicators point to a faster slowdown of private consumption in the last months of 2008 compared to what appears to have been expected in the programme update. In line with the more optimistic GDP forecast, the programme projects the labour market to fare better and inflation to remain higher than projected in the Commission services' interim forecast. However, the latter discrepancies between the two forecasts are relatively small. The bulk of the stimulus measures described in the programme were decided upon prior to the formulation of the macroeconomic scenario underlying the programme. Therefore, while the programme does not separately quantify the assumed impact on growth from the stimulus measures, the programme projections appear to implicitly take account of their impact.

The output gap and potential growth estimates as recalculated by Commission services based on the information in the programme, following the commonly agreed methodology, indicate that economic activity is expected to fall below potential in 2009. Economic growth is projected in the programme to recover to growth rates close to potential only by 2011. According to the Commission services' interim forecast, the deterioration in cyclical conditions, as measured by the output gap, would be more marked over 2008-2010.

Table I: Comparison of macroeconomic developments and forecasts

	2008		2009		2010		2011	2012
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	1.5	2.6	-1.2	0.6	1.2	1.8	2.4	2.2
Private consumption (% change)	2.2	3.0	0.5	1.8	1.8	2.3	2.2	2.0
Gross fixed capital formation (% change)	2.1	2.1	-3.8	-2.7	0.3	-1.5	2.6	2.1
Exports of goods and services (% change)	1.5	3.4	-4.0	-0.4	1.1	4.0	5.0	4.5
Imports of goods and services (% change)	1.2	3.0	-1.7	0.0	1.4	3.4	4.0	3.5
Contributions to real GDP growth:								
- Final domestic demand	1.8	2.3	-0.1	0.8	1.3	1.2	2.0	1.8
- Change in inventories	0.4	0.0	0.0	0.0	0.0	0.2	-0.1	-0.2
- Net exports	0.2	0.3	-1.1	-0.2	-0.1	0.4	0.6	0.6
Output gap[1]	1.7	1.3	-1.4	-0.6	-2.1	-1.0	-1.2	-1.3
Employment (% change)	1.4	1.5	-1.5	-1.1	-0.3	-0.2	0.2	0.1
Unemployment rate (%)	6.4	6.3	7.8	7.1	8.0	7.2	6.8	6.6
Labour productivity (% change)	0.1	1.2	0.3	1.8	1.6	2.0	2.2	2.1
HICP inflation (%)	3.9	4.0	1.8	2.3	1.8	1.9	2.0	2.0
GDP deflator (% change)	3.2	3.6	1.7	1.8	1.9	2.1	2.0	2.0
Comp. of employees (per head, % change)	5.7	5.7	4.3	5.1	4.2	5.0	4.0	4.0
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	5.2	4.0	3.7	3.6	3.3	3.7	3.9	3.9

Note:

[1] In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.

Source:

Commission services' January 2009 Interim economic forecasts (COM); Stability programme (SP)

4. BUDGETARY STRATEGY

1.1. Budgetary implementation in 2008

The Commission services' January 2009 interim forecast expects the general government surplus to reach 4.5% of GDP in 2008, which is close to the 4.4% of GDP projected in the programme. This is considerably higher than the target of 3.7% of GDP set in the previous update of the stability programme (see Table 1 in Annex 2). The difference arises mainly from the base effect as the surplus recorded in 2007 was 0.8 percentage points higher than planned. The revenue surprise in 2007 originates from two sources. Firstly, economic growth was higher than expected in 2007, boosting tax revenue while expenditure remained contained. Secondly, a change in the recording of property income from social security's assets contributed to revise upwards the surplus by almost 0.4% of GDP (for further details, see the previous Commission assessment of the 2007 Stability Programme update). The underlying revenue and expenditure trends in 2008 have remained close to what was planned in the previous programme update. The rapid deceleration of economic activity had a muted impact on tax revenues in 2008. This is explained by the relatively strong wage growth determined by collective agreements and time lags in the labour market response to the economic downturn. Also, nominal consumption growth was relatively buoyant in the first half of 2008. Nevertheless, tax accrual has been on a slowing path over the course of 2008. In 2008, expenditure was largely unaffected by the dramatic changes in the economic environment and the Government's stimulus measures will largely kick in from 2009 onwards.

1.2. Near-term budgetary strategy

The programme plans for the general government balance to drop by 2.3 pp. in 2009 from the previous year, and by a further 1 pp. in 2010. The reduction in the surplus ratio is largely expenditure driven. Over the two years until 2010, expenditure to GDP ratio is set to increase by 1.6 pp. while revenue ratio will edge down by 0.7 pp.

The structural balance, i.e. cyclically adjusted balance net of one-off measures as recalculated by the Commission services on the basis of the information in the programme, is set to decline by about 1% in 2009 from the previous year, indicating an expansionary fiscal stance in that year. This estimate broadly matches the size of the stimulus measures announced in the programme.

The projections included in the programme take account of the initial package of stimulus measures as they are included in the 2009 budget bill and in its amendments from 20 November 2008, adopted by the Parliament on 19 December 2008. The stimulus package, amounting to 1.2% of GDP in 2009, concentrates largely on tax cuts supporting consumers' purchasing power. The tax cuts (further detailed in Table II) make up over three quarters of the stimulus package size and amount to 0.9% of GDP. These tax cuts are also part of Government policy to reduce personal income taxation over the legislative period from 2008-2012 and are thus not meant to be reversed once the economy recovers. Upon taking office in spring 2007, the Government foresaw to reduce personal income tax in real terms, i.e. adjusted for inflation and tax scales, by 1.1 billion euro, corresponding to 0.6% of 2009 GDP (the majority of this, or 0.87 billion is implemented in 2009). It was planned to time implementation of the tax cuts to periods of weak economic times. Aside from stimulating domestic demand, the long-term objective is to reduce the relatively high tax burden on labour and increase employment incentives. Additionally, VAT tax rate on food will be permanently reduced as of October 2009. This will reduce annual tax income by 0.25% of GDP in 2010, but only marginally in 2009. Therefore, while the size of the measure is substantial overall, its share in the 2009 stimulus package is negligible. In addition to the above tax measures, decided by the Government in August 2008, other stimulus measures were designed over autumn 2008. About 0.2% of GDP is spent on capital injections[2] to state controlled entities supporting and guaranteeing companies' financing and about 0.1% of GDP on boosting various infrastructure investments.

On 30 January 2009 the government announced an additional stimulus package with a broad range of measures stimulating infrastructure and housing investment with a particular objective of upholding employment, increasing funding for education and research, and lowering labour costs by decreasing employers' social insurance contribution. The budgetary cost of the additional measures amounts to 0.5% of GDP in 2009. Given the later publication date, those measures are not incorporated into the programme projections nor into the Commission services' January 2009 interim forecast. Therefore, their impact is not reflected in the numeric projections of the current macro fiscal assessment.

[2] Some of those capital injections might be recorded above the line in national accounts.

Overall, the stimulus packages comply with the general principles of the Commission Communication of 26 November 2008 on the European Economic Recovery Plan. In particular, the mix of revenue and expenditure measures appear to be targeted towards the internal sources of economic challenges, notably by giving support to domestic demand and stabilising financing condition for Finnish companies. They are timely, taking largely effect from the beginning of 2009. Contrasting with the general principles of EU wide recovery plans, the bulk of the fiscal stimulus is given through permanent tax cuts, which are not planned to be reversed. This can be considered partly justified given the initial strong position of the Finnish public finances and the long-term tax policy goals of the government. Nevertheless, taking account of concerns for the long-term sustainability of public finances (detailed in section 5.2.), once the economy recovers, the fiscal loosening would have to be reversed.

Table II. Main budgetary measures for 2009[3]

Revenue measures[1]	Expenditure measures[2]
Measures in response to the downturn	
• Income tax cuts (-0.7% of GDP) • Lowering tax on pension income (-0.1% of GDP) • Increasing various tax deductibles (-0.1% of GDP)	• Supporting enterprises access to finance (0.2% of GDP) • Boosting infrastructure investment (0.1% of GDP) • Boosting construction of rental housing (0.05% of GDP)
Other measures	
• Increases of alcohol and tobacco excises (0.05% of GDP)	• Funding municipal mergers (0.05% of GDP)

<u>Note</u>:

[1] Estimated impact on general government revenue

[2] Estimated impact on general government expenditure

<u>Source</u>: Commission services, Finnish Ministry of Finance 2009 Budget Review and budget amendment of 20 November 2008.

In addition to the stimulus measures with a direct budgetary impact, the government has authorised various state-controlled entities to increase their provision of guarantees, export credits and interest subsidies with the aim of improving financing conditions for enterprises and boost housing investment. Although the Finnish financial sector appears to be less affected by the global crisis, the banking sector was provided with sizeable support facilities, designed to boost their lending capacity. These measures give commercial banks access to significant credit guarantees (maximum amount of about 25% of GDP) and capital investment by the state (maximum amount of about 3% of GDP). Also, the ceiling of the depositors' guarantee was doubled to 50 000 EUR. However, given that the Finnish financial sector

[3] The stimulus measures decided by the Government on 30 January 2009 are not included in these figures.

appears to be relatively less affected by the global crisis, the actual utilisation of state funds could turn out to be limited.

Table III. Comparison of budgetary developments and projections

(% of GDP)	2007	2008		2009		2010		2011	2012	Change: 2008-2012
	COM	COM	SP	COM	SP	COM[1]	SP	SP	SP	SP
Revenue	**52.6**	**52.3**	**51.4**	**52.0**	**50.3**	**51.3**	**49.7**	**49.4**	**49.4**	**-1.9**
of which:										
- Taxes on production and imports	13.0	12.9	12.7	13.0	12.7	12.6	12.2	12.0	11.9	-0.8
- Current taxes on income, wealth, etc.	17.5	17.3	17.1	16.8	16.4	16.5	16.3	16.1	16.1	-0.9
- Social contributions	12.0	11.9	11.7	12.2	11.8	12.3	12.1	12.1	12.2	0.5
- Other (residual)	10.0	10.1	9.9	10.1	9.4	10.0	9.2	9.1	9.2	-0.7
Expenditure	**47.3**	**47.8**	**47.0**	**50.1**	**48.2**	**50.9**	**48.6**	**48.4**	**48.5**	**1.5**
of which:										
- Primary expenditure	45.8	46.3	45.5	48.7	46.9	49.5	47.3	47.2	47.2	1.6
of which:										
Compensation of employees and intermediate consumption	21.9	22.2	n.a.	23.4	n.a.	23.7	n.a.	n.a.	n.a.	n.a.
Social payments	17.3	17.4	n.a.	18.3	n.a.	18.7	n.a.	n.a.	n.a.	n.a.
Subsidies	1.2	1.2	1.2	1.3	1.2	1.3	1.2	1.2	1.2	0.0
Gross fixed capital formation	2.6	2.6	2.6	2.8	2.5	2.8	2.5	2.4	2.3	-0.2
Other (residual)	2.8	2.8	5.5	3.0	5.7	3.0	5.6	5.6	5.5	0.0
- Interest expenditure	1.4	1.5	1.5	1.4	1.3	1.4	1.3	1.2	1.3	-0.1
General government balance (GGB)	**5.3**	**4.5**	**4.4**	**2.0**	**2.1**	**0.5**	**1.1**	**1.0**	**0.9**	**-3.4**
Primary balance	**6.8**	**6.0**	**5.8**	**3.3**	**3.4**	**1.8**	**2.4**	**2.2**	**2.3**	**-3.6**
One-off and other temporary measures	0.0	0.0	n.a.	0.0	n.a.	-0.2	n.a.	n.a.	n.a.	n.a.
GGB excl. one-offs	**5.3**	**4.5**	**n.a.**	**2.0**	**n.a.**	**0.7**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
Output gap[2]	2.9	1.7	1.3	-1.4	-0.6	-2.1	-1.0	-1.2	-1.3	-2.6
Cyclically-adjusted balance[2]	3.9	3.6	3.7	2.7	2.4	1.5	1.7	1.6	1.6	-2.1
Structural balance[3]	**3.9**	**3.6**	**3.7**	**2.7**	**2.4**	**1.7**	**1.7**	**1.6**	**1.6**	**-2.1**
Change in structural balance		*-0.3*	*-0.2*	*-0.9*	*-1.3*	*-1.0*	*-0.7*	*0.0*	*-0.1*	
Structural primary balance[3]	5.3	5.1	5.2	4.1	3.7	3.1	3.0	2.8	2.9	-2.3
Change in structural primary balance		*-0.2*	*-0.2*	*-1.0*	*-1.5*	*-1.0*	*-0.7*	*-0.1*	*0.0*	

Notes:

[1]On a no-policy-change basis.

[2]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the information in the programme.

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

Source:

Stability programme (SP); Commission services' January 2009 interim forecasts (COM); Commission services' calculations

1.3. Medium-term budgetary strategy

As in the previous programme, Finland's medium-term objective (MTO) for the budgetary position is defined as a general government surplus of 2% of GDP in structural terms, i.e. in cyclically-adjusted terms net of one-off and other temporary measures. The government's programme, settled upon the cabinet taking office in spring 2007, intends to make additional provisions for the ageing challenge. It expects that structural reforms boosting employment could result in a surplus of 1% of GDP by 2011 in central government finances, which would be approximately equivalent to a surplus of 3½ % of GDP on the general government level.

Additionally, the Government is committed to ensuring that, even in adverse economic conditions, the central government deficit does not exceed 2½ % of GDP. Taking account of the surplus in social security funds, this would keep general government finances close to balance even during economic downturns.

The headline primary and structural surpluses are expected by the programme to decline steeply in the first two years of the programme period, but stabilise at the level reached after 2010. The headline surplus is projected to drop to about 1% of GDP by 2010. The corresponding structural surplus estimate is slightly higher at 1½ % of GDP. This is marginally short of the MTO target of 2% of GDP. The reduction in the surplus ratio over 2008-2012 is driven by a combination of a decline in the revenue ratio by about 2% of GDP (notably led by weak VAT and income tax revenue prospects) and a rise in the expenditure ratio by 1½ % of GDP (see Table III).

The Government has not defined an official stimulus package for 2010. However, the budgetary projections do indicate an expansionary fiscal stance in 2010 as well, measured by the decline in the recalculated structural balance by about 1 p.p. Of this, about 0.25% of GDP is accounted for by the permanent cut of VAT tax rate on food as of October 2009[4]. From 2011 onwards, the fiscal policy stance turns neutral. Based on a no policy change assumption, the programme does not include measures for a fiscal retrenchment once the economy recovers.

The fiscal performance of different government sectors varies. The central government surplus of over 1% of GDP in 2008 is projected by the programme to turn in the following two years into a deficit of over 1% of GDP, maintained at the same level over the programme period. Local government finances are also seen to deteriorate, albeit marginally and slide only into a slight deficit. The surplus at the general government level will therefore be solely upheld by the social security funds, expected to still post a surplus of 2½ % of GDP in 2012.

1.4. Risks to the budgetary targets

The sizeable differences in the economic forecast of the Commission services and the programme update have not led to an equally large disparity in public finance projections. The Commission services project the general government balance to decline to 0.5% of GDP by 2010, which is only slightly less that the 1.1% expected in the programme update. While the expenditure and revenue ratios to GDP show significant differences between the two forecasts, this arises from the denominator effect as the programme's calculations are based on higher nominal GDP values in 2008 and 2009, carrying over to the following years. The programme's nominal revenue and expenditure projections are broadly in line with the Commission services' forecast, being only somewhat optimistic on income tax and VAT revenue.

The relatively small difference in general government balance projections is explained by several factors. The Commission services expect that the contraction would be led to a greater degree by the weakness of the external sector, which is, however, a less tax intensive demand component. The prospects for the labour market and wage growth, which forms the basis for the income tax revenues, are seen more similarly. Therefore the contraction in GDP would be larger than the decline in the taxes to GDP ratio. The comparison of tax elasticities reveals

[4] As mentioned above, the stimulus package decided by the Government on 30 January 2009 is not included in these projections. The cut of employers' social security tax would amount to about 0.4% of GDP in 2010.

that overall, the programme is based on plausible tax elasticity assumptions for 2009 and 2010. The programme only appears more optimistic than the Commission services on the assumed income tax elasticity to growth in compensation of employees. While the VAT elasticity to private consumption growth is similar between the two forecasts, the Commission services project weaker growth for private consumption in 2009 and thus also weaker VAT revenue.

In terms of assessing the risks of different government sectors, it appears the central government finances would be the most affected by the downturn, slipping into a deficit of 1½ % of GDP by 2010. The risk of a further significant deterioration is capped by the government's self-imposed central government deficit limit of 2½% of GDP even in adverse economic conditions. However, in the event of breaching this limit, the corrective measures would not be automatically implemented and would require legislative action. Local government finances might be on the aggregate resilient to the economic downturn, given that their primary tax base is compensation of employees, which is expected to remain robust. Additionally, local governments are able to adjust flexibly some of their expenditure categories and increase the local tax rates (for more details, see Annex 1). The revenue base of social security (pension funds) is also more dependent on personal income growth than solely GDP developments.

In conclusion, while the programme appears to be based on a too favourable growth projection for the time the current economic crisis is expected to last, the growth prospects in some of the main tax bases, namely private consumption and household income, are expected to show greater resilience in an economic contraction led by a slump in external demand. Therefore, a weaker outturn in economic growth would likely lead to a relatively smaller deterioration in public finances. The overall balance of risks indicates that the budgetary outcomes projected in the programme are subject to downside risks.

5. DEBT DEVELOPMENTS AND LONG-TERM SUSTAINABILITY

1.5. Debt developments

On account of the budgetary surpluses and solid growth in nominal GDP, the general government gross debt ratio has persistently declined over the past years, reaching about 35% of GDP in 2007. In 2008, the ratio is projected to have declined further by over 2 p.p.. However, on account of the foreseen weakening of public finances, the programme update projects the gross debt ratio to gradually edge up over the programme period, reaching 34.6% of GDP in 2012. This arises in the main from the central government finances turning into a deficit. The surplus in social security funds reflects the accumulation of assets to pension schemes, which does not impact general government debt[5]. The Commission services forecast a steeper rise in the debt ratio than the programme update. As presented in Table IV, this difference over the years 2009-2010 originates from a weaker primary balance projection, "growth effect" (lower nominal GDP), and differences in the projected size of the stock flow adjustment in 2009.

The stock of assets controlled by pension schemes has increased rapidly in the past years, reflecting good profitability of the funds and accumulation of contributions exceeding the

[5] Under the assumption that these assets are invested outside the general government sector

current pension payments. The pension schemes' consolidated financial assets amounted to over 57% of GDP in 2007, substantially exceeding government gross debt. Considering the continuous reduction of the gross debt ratio, net assets of the general government have increased robustly over the past years. Data for 2008 is not yet available, but it can be assumed that the crash in the global financial markets has considerably reduced the value of the pension fund assets. This would reduce the net assets position of the general government and influence negatively long-term sustainability.

Table IV: Debt dynamics

(% of GDP)	average 2002-06	2007	2008		2009		2010		2011	2012
			COM	SP	COM	SP	COM	SP	SP	SP
Gross debt ratio[1]	**42.1**	**35.1**	**32.8**	**32.4**	**34.5**	**33.0**	**36.1**	**33.7**	**34.1**	**34.6**
Change in the ratio	-0.6	-4.1	-2.4	-2.7	1.7	0.6	1.6	0.7	0.4	0.5
Contributions [2] :										
1. Primary balance	**-4.9**	**-6.8**	**-6.0**	**-5.8**	**-3.3**	**-3.4**	**-1.8**	**-2.4**	**-2.2**	**-2.3**
2. "Snow-ball" effect	**0.2**	**-1.3**	**-0.1**	**-0.6**	**1.2**	**0.5**	**0.3**	**0.1**	**-0.2**	**0.0**
Of which:										
Interest expenditure	1.7	1.4	1.5	1.5	1.4	1.3	1.4	1.3	1.2	1.3
Growth effect	-1.2	-1.6	-0.5	-0.9	0.4	-0.2	-0.4	-0.6	-0.8	-0.7
Inflation effect	-0.3	-1.1	-1.1	-1.2	-0.6	-0.6	-0.6	-0.6	-0.7	-0.6
3. Stock-flow adjustment	**4.1**	**4.0**	**3.7**	**3.8**	**3.9**	**3.4**	**3.1**	**3.0**	**2.9**	**2.8**
Of which:										
Cash/accruals diff.	0.0	-0.5		n.a.		n.a.		n.a.	n.a.	n.a.
Acc. financial assets	4.2	4.6		3.2		2.9		2.9	2.8	2.7
Privatisation	-0.9	-0.5		-0.2		-0.2		-0.2	-0.2	-0.2
Val. effect & residual	-0.1	0.0		-1.6		-0.3		-1.1	-1.4	-1.2

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); Commission services' January 2009 interim forecasts (COM); Commission services' calculations

1.6. Long-term sustainability

This section presents sustainability indicators based on the long-term age-related government spending as projected by the Member States and the EPC in 2006 according to an agreed methodology.[6]

Table 3 in the Annex shows that the age-related spending is projected to rise by 5 percentage points between 2010 and 2050, above the EU average. Sustainability indicators for two scenarios are presented in Table 4 in the Annex. Including the increase of age-related

6 Economic Policy Committee and the European Commission (2006), 'The impact of aging on public expenditure: projections for the EU-25 Member States on pensions, health care, long-term care, education and unemployment transfers (2004-50)', *European Economy − Special Report* No. 1/2006. European Commission (2006), The long-term sustainability of public finances in the European Union, European Economy No. 4/2006. European Commission (2008), *Public finances in EMU – 2008, European Economy* No. 4/2008.

expenditure and assuming that the structural primary balance remained at its 2008 level, Finland has almost no sustainability gap in the baseline scenario (S2 is 0.1% of GDP).[7] The starting budgetary position is sufficient to stabilize the debt ratio over the long-term and offsets the long-term budgetary impact of ageing. However, if the 2009 budgetary position of the Commission services' January 2009 forecast was taken as the starting point, the sustainability gap would widen by 1½% of GDP.

The "programme scenario", which is based on the end-of-programme structural primary balance, projects the budgetary situation to deteriorate. Risks to long-term sustainability of public finances would increase, as shown by the sustainability gap (S2) reaching 2.5% of GDP.

Based on the assumptions used for the calculation of the sustainability indicators, Figure 4 in the Annex displays the projected debt/GDP ratio over the long-term. For an overall assessment of the sustainability of public finances, other relevant factors are taken into account, as shown in Table 5 in the Annex. Notably, the programme discusses the implications of variations in the rate of return on the assets held in the pension system.

While the long-term budgetary impact of ageing is higher than on average in the EU, enacted pension reforms have helped to contain the projected increase in pension expenditure over the coming decades. The budgetary position in 2008 as estimated in the programme, with a large structural surplus, contributes significantly to offsetting the long-term budgetary impact of ageing and the large assets accumulated by the public pension schemes will help finance part of the increase in pension expenditure. However, from the budgetary developments planned in the programme, a sustainability gap would arise. Maintaining high primary surpluses over the medium term would contribute to limiting risks to the sustainability of public finances, which are currently at a low level.

6. INSTITUTIONAL FEATURES OF PUBLIC FINANCES

The budgetary framework is aimed at controlling central government budget expenditure and is based on yearly spending limits. Its institutional setup will likely remain broadly stable over the programme period, as the medium-term budgetary framework has proven to be effective in avoiding expenditure overruns.

With the long term goal to reduce the relatively high tax burden on labour and increase employment incentives, income taxation is to be reduced over the government legislative period 2008-2012. As detailed in the previous section 4.2., the tax cuts implemented as part of the 2009 stimulus package also serve this longer term goal. The exact magnitude and timing of the remaining tax cuts will be decided in connection with the mid-term review of the governments' programme in early 2009.

The measures addressing the current economic crisis are focused on sustaining aggregate demand and employment, as well as strengthening competitiveness. The measures are related to the medium-term reform agenda for Finland as reviewed by the Commission on 28 January

7 The S2 indicator is defined as the change in the current level of the structural primary balance required to make sure that the discounted value of future structural primary balances (including the path of property income) covers the current level of debt.

2009. In particular, the measures stimulating investment also target improving energy efficiency, and the tax cuts stimulate both labour demand and supply.

The programme update has not radically altered the government's public finance strategy, nor the reform measures, that have in the main been under implementation over several past years. The principal reforms measures concern the reorganisation of service provision both at the central and local government level, aiming to curb expenditure pressures in the long run. The reform measures in these areas are advancing well overall and within the planned timeframe. The central government has further strengthened its productivity programme, altogether aiming to reduce personnel by over 10% up until 2015

7. ASSESSMENT

This section assesses the budgetary strategy, taking into account risks, in the light of (i) the adequacy of the fiscal stimulus package in response to the Commission Communication of 26 November 2008 on the European Economic Recovery Plan (EERP) as endorsed by the European Council conclusions on the European Economic Recovery Plan (EERP) on 16 December 2008 and the overall fiscal stance (ii) the criteria for short-term action laid down the above mentioned Commission Communication, and (iii) the objectives of the Stability and Growth Pact.

The announced Government measures included in the programme amount to 1.2% of GDP in 2009. This is broadly in line with the Commission services estimate of structural surplus declining by about 1% in 2009 from the previous year. The programme update and the current government's stimulus package do not specify fiscal stimulus measures for 2010, although the VAT cut on foodstuffs alone would indicate a fiscal stimulus of about 0.25% of GDP in 2010. Gauged by the annual decline in the structural balance, it appears the fiscal stimulus would amount to around 1% of GDP also in 2010. Additionally, the automatic stabilisers are estimated to contribute by 1½ % of GDP in 2009 and ½ % in 2010. In view of the sizeable fiscal space afforded by the strong budgetary starting position and solid fundamentals of the economy, the stimulus measures of the programme update and the latest measures announced in January 2009 appear appropriate, provided that action will also be taken for fiscal retrenchment in the medium term to ensure long term sustainability. Finland has over the several past years pursued various structural reforms to improve the quality of public finances and reduce the long term expenditure pressures. Nevertheless, it is likely that also short term discretionary measures would be needed to reverse the fiscal loosening once the economy recovers. The current programme update does not specify any such measures. However, the programme acknowledges that the baseline scenario of general government balance outlined on a no policy change assumption does not meet the government's fiscal targets. It also states that the government will assess the need for any additional reforms with a view of launching them while still in office, i.e. by 2011.

The stimulus package broadly complies with the general principles of the European Economic Recovery Plan. In particular, the mix of revenue and expenditure measures comes timely, taking largely effect from the beginning of 2009. The measures also appear to be targeted to address the internal economic challenges, giving support to domestic demand and stabilising financing condition for Finnish companies. Contrasting with the general principles, the bulk of the fiscal stimulus is not planned to be reversed, since it is given through permanent tax cuts. This can be considered partly justified given the sizeable leeway afforded by public finances and the long-term tax policy goals of the Government. Nevertheless, with a view of ensuring long-term sustainability of public finances, the fiscal loosening would have to be reversed in the medium term.

The budgetary stance in the programme appears broadly in line with the Stability and Growth Pact. The Programme update appropriately allows for a fiscal stimulus during a recession and a neutral fiscal stance once the economy is forecast to have recovered to growth rates close to the estimated potential. However, while the budgetary stance at the end of the programme period would also maintain a large safety margin against breaching the 3% deficit threshold, it is projected by the programme update, as well as Commission services, to decline marginally below the MTO by 2010, and is not seen to rebound over the programme period based on a no policy change assumption.

ANNEX 1. SPECIAL TOPIC: LOCAL GOVERNMENT CHALLENGES

1. INTRODUCTION

Finland has in practice a two-level governance system: a central and a municipal (local) level[8]. The following section will focus specifically on the challenges that population ageing will bring to local government finances, as it is this level of governance that will likely be the most affected. Age-related expenditure is projected to rise by about 5 percentage points by 2050, which is higher than in the EU on average. The burden of the additional expenditure will be mainly divided between the social security system (pensions[9]) and local governments, which are responsible for the provision of the bulk of ageing-related services (notably health and long-term care services). The sustainability of the social security system has been boosted through a strategy of extensive saving, building up pension fund assets amounting to over 57% of GDP in 2007. Local governments will yet have to adjust to the demographic shifts and related financing pressures. This will likely lead to a fundamental shift in local governance and service provision.

2. LONG TERM CHALLENGES TO LOCAL GOVERNMENTS.

The population ageing challenge is multifaceted, and is not limited only to the sustainability of public finances. The previous Macro Fiscal Assessment[10] highlighted the effects of population ageing to the economic growth potential and its repercussions for public finances. The local governments will be in particular affected by the pressure to increase its staff numbers in response to higher demand for services. Higher employment in public services is not only a concern from the fiscal standpoint, but also due to crowding out employment in the other (open) sectors of the economy in a setting of declining labour supply.

Municipalities (or alternatively municipal partnership areas) have the responsibility to provide most of the public services, like healthcare, education, social and cultural services. Consequently, they account for about 75% of general government employment (ca 20% of total national employment) and they largely determine the overall public sector employment trends. Wage costs account for about a half of municipal expenditure (see further Figure 5). Nevertheless, in terms of aggregate expenditure, municipalities spend lightly less than the central government, largely because social transfers are part of the central government budget.

The evolution of both municipal staff numbers and wages is a significant determinant of expenditure pressures. Over the past decade, expenditure has consistently grown faster in local governments than in the central government (Figure 1). Local government expenditure growth has accounted for close to half of the general government expenditure increases. It appears that the central government mid-term expenditure ceilings have been relatively more effective in constraining expenditure growth.

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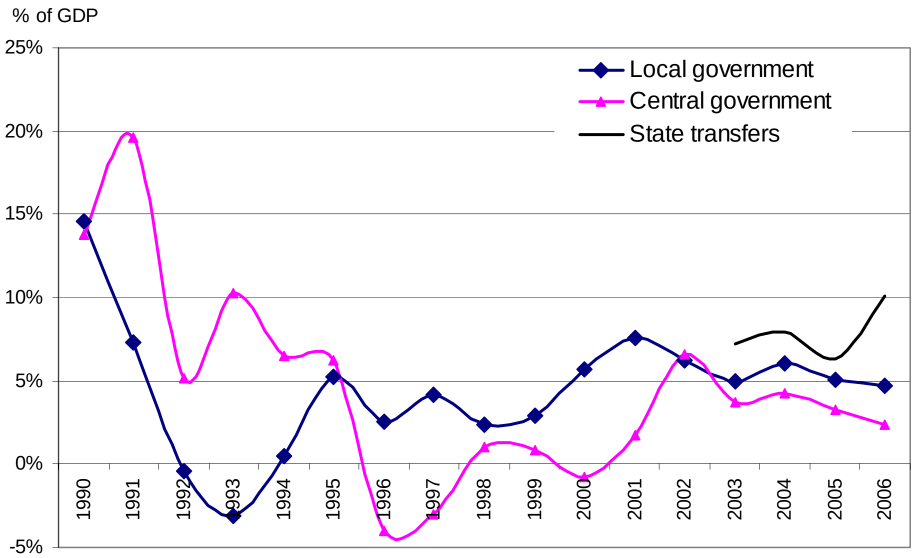
[8] A third level of governance, the regional level, is of limited scope and importance.

[9] A minor part of the pension schemes is also recorded in the national accounts under central government.

[10] http://ec.europa.eu/economy_finance/publications/publication_summary11842_en.htm

Figure 1: Expenditure growth in local and central government, growth in state transfers to local governments (need data for before 2003)



Source: Statistics Finland ASTIKA database

The central government has defined ambitious targets to reduce its personnel over the medium term as part of a productivity programme, with the double aim of increasing productivity and adjusting to a shrinking workforce. It is planned to cut central government employment by 9600 over 2007-2011 and by a further 4800 during 2012-2015, in total representing over 10% of central government staff. The local governments, having a high degree of autonomy, are not constrained in recruitment policy. The Finnish Ministry of Finance has estimated[11] that the recruitment needs in the local governments will increase by 60 000 people by 2025 in response to higher demand for ageing-related services. It is therefore likely that personnel costs at the local governments will grow significantly faster than at the central government. Having regard to the so called Baumol effect[12], we can expect that in the long run the municipal wages would rise at least in step with overall wages. However, in the medium run, the current wage settlement round provided for above-the-average wage growth for municipal employees (most notably healthcare), mainly justified by the relatively low wages of many Finnish public service jobs by international standards. The catch-up to internationally comparable wage levels might be further spurred in some municipal sectors which are already now suffering from labour shortages (notably social- and health care).

Some public sector responsibilities could be transferred relatively easily to the private sector. During the recession years in the beginning of the 1990s, central government employment dropped dramatically (Figure 2). It was largely due to reshuffling government agencies into the private and municipal sector[13], while employment in core public services (public

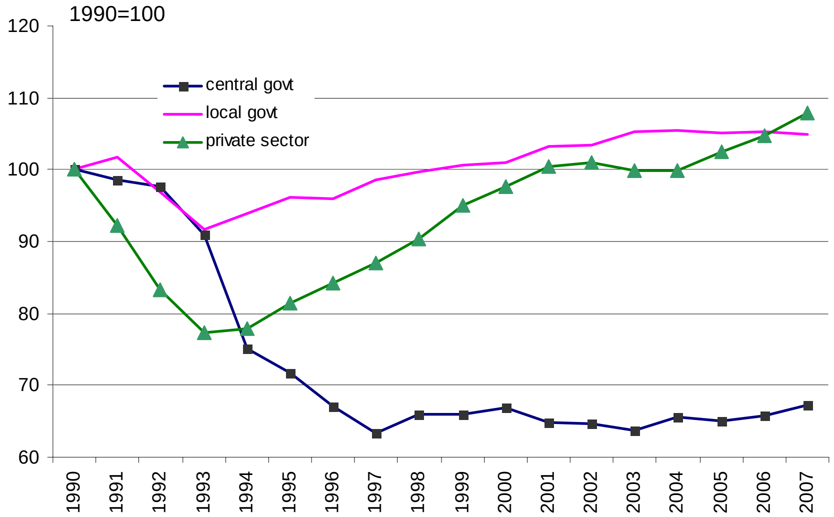
[11] Ministry of Finance, Economic Outlook, September 2008.

[12] Baumol effect postulates that public sector wages will inevitably adjust upwards (even in the absence of productivity gains) in response to a rise of productivity and wages in the more productive open sectors.

[13] Ministry of Finance and Commission for Local Authority Employers (2006), The Finnish Public Sector in Brief, Helsinki.

administration-, health- and education) remained relatively stable[14]. This might ease pressures on public finances to some extent as the financing requirement can be transferred from taxes to direct consumer fees. However, it would bring net economic benefits only if the change in service provision leads to productivity gains.

Figure 2: Employment dynamics in local and central government and private sector



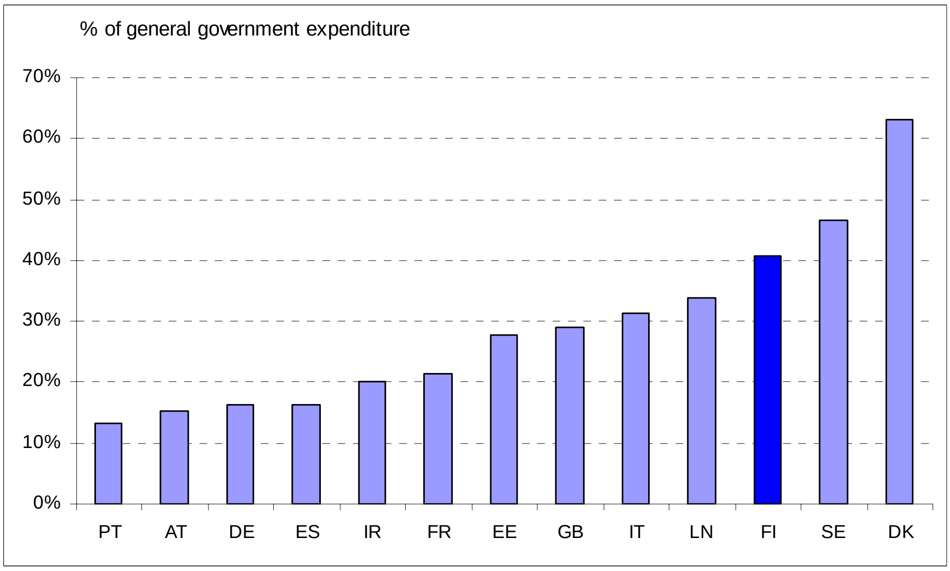
Source: *Statistics Finland ASTIKA database*

2.1. The role of the local governments in fiscal policy

Municipalities play a relatively large role in the Finnish economy. International comparisons show that the expenditure-to-GDP ratio of Finnish local governments is the third highest in the EU, only surpassed by Denmark and Sweden (Figure 3).

[14] See the previous Macro Fiscal Assessment section 2 for further discussion.

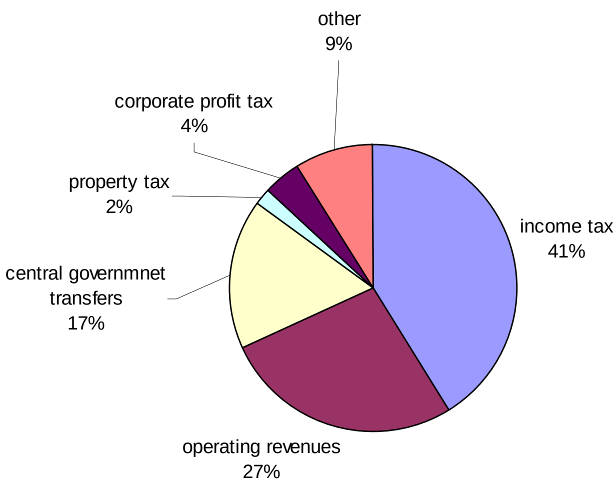
Figure 3: Share of local government expenditure in general government, 2007



Source: Eurostat

In Finland, the constitution grants the local governments a high degree of self-governance, including the right to determine its own expenditure and set the municipal income tax rate without limitations and property taxation within certain nationally defined boundaries. Almost half of local government revenues come from direct taxes (Figure 3), of which municipal income tax (payable by residents) accounts for about 95%. Operating revenues account for over one quarter and state transfers for about 17% of revenues. The state transfers are designed to equalise differences in both expenditure needs and income. Municipalities also receive a share of corporate profit tax.

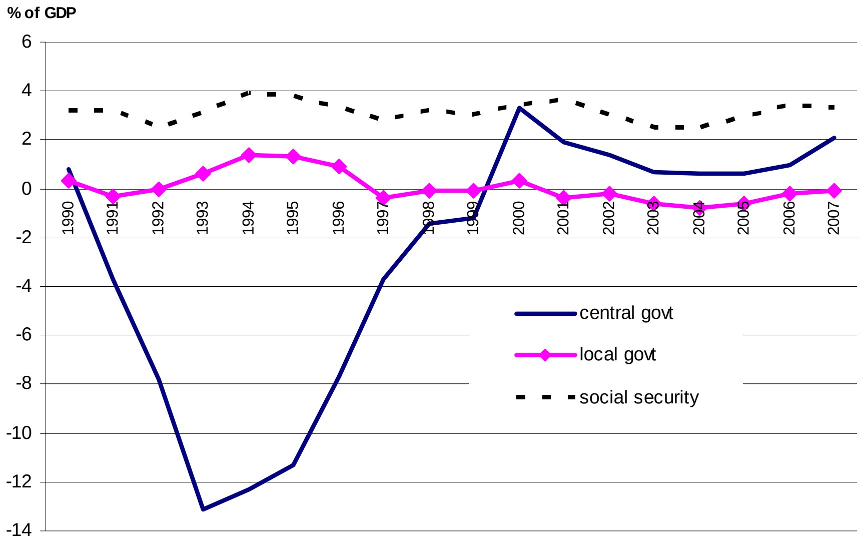
Figure 4: Revenue structure of municipalities, 2004



Source: OECD, Finnish Ministry of Interior

While the municipalities have leeway in determining their own tax rates and expenditure, it is still the central government finances that have largely determined the overall fiscal stance (Figure 5), showing the largest annual fluctuations in net lending. Even though the fiscal strength of individual local governments varies greatly, on the aggregate their budgetary position has remained rather stable close to a zero-balance position with little impact from the economic cycle. The local government debt level was therefore relatively insignificant at just over 5% of GDP in 2007. In contrast the central government debt amounted to over 32% of GDP. Social security finances have stayed relatively stable at a significant surplus position, over time accumulating financial assets amounting to over 57% of GDP in 2007.

Figure 5: Net lending of local and central government and social security



<u>Source</u>: Eurostat

Compared with the central government, the local government finances are much less responsive to the economic cycles. While the central government slipped into a large deficit during the recession of the early 1990s, local governments even increased their surplus. This relative stability can be largely explained by the overall setup of public finances, as the more cyclically sensitive revenue and expenditure items (notably consumption taxes and unemployment expenditure) are part of the central government. However, also discretionary measures taken by the local governments themselves have played a stabilising role. In effect, this is also required of local governments as they are obliged to balance their budgets over a 3 year period, though effectively with no sanctioning mechanism. Local governments have room for their own revenue and expenditure measures. On the revenue side, municipal tax rates have been increased consistently during periods of relatively higher expenditure needs or lower revenues (i.e. periods when more tasks have been delegated to municipalities, times of insufficient financial transfers from the central government, and economic recession of the early 1990s). Average municipal tax rates have increased by over 5 percentage points from 1970 to 2008[15]. Over the recent years, from 2005 to 2007, the relatively rapid rise in municipal expenditure resulted in a 0.75 pp. hike in the average municipal income tax,

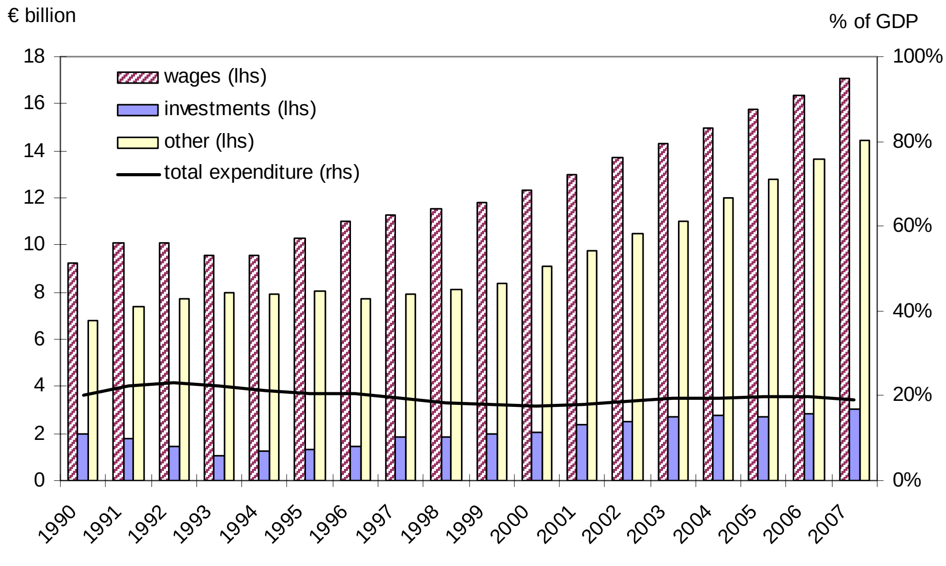
[15] Government Institute of Economic Research (2008), Structural Indicators, Helsinki.

reaching 18.5% on average. Additionally, as presented previously in Figure 1, the growth in central government transfers has surpassed municipal expenditure in recent years.

Municipal tax dynamics contrast with the extensive income tax cuts on the national level. This has lead to concerns that the local government tax rises would undermine income tax policy at the state level and provide for an easy loophole to finance rising expenditure[16]. Furthermore, currently the range of municipal tax rates varies by some 5 percentage points. While the state transfer system largely equalises municipal finances, it can not fully compensate for weaker regional economic potential or higher investment needs. As a result, generally the financially weaker and less populous municipalities tend to maintain higher tax rates. The differences in tax rates might create further competitive advantages for stronger municipalities in attracting taxpayers and business investment, undermining regional policy.

On the expenditure side, local governments appear to be able to adjust costs in the short run particularly through investment activity (Figure 5). During the economic recession in the early 1990s, local governments cut investments by 40%. This has also wider implications for the aggregate investment activity as local governments account for over half of general government investments and about 8% of investments in the total economy. The flexibility of some expenditure categories might allow the local governments to cover expenditure rises in others and avoid building up debt. However, this points to the risk that rising population ageing costs might crowd out some other types of expenditure or result in reduced service quantity and quality.

Figure 6: Evolution of nominal wage and investment expenditure in local governments



Source: Statistics Finland ASTIKA database

[16] OECD, 2008 Economic Survey of Finland ; IMF, 2007 Article IV Consultation—Staff Report

2.2. Policy response

To address the demographic challenges, the government has designed productivity- and sustainability-enhancing reforms for all levels of government, most notably on central and local government level (also an integral part of the Finnish National Reform Programme). A recent reform initiative announced in spring 2008 refers also to the regional government level, which is however of limited size and importance in Finland. The framework law promoting the reform of local governments' structure and their service provision was passed by the parliament in the beginning of 2007. The goal is to redesign municipal service provision and financing to a more sustainable basis. The reform aims to achieve an increase in productivity and efficiency through both economies of scale (forming larger municipalities) and innovations in service provision. An important facet of the reform is redesigning the state transfer system, with a view of enhancing transparency, productivity and cost efficiency. The concrete legislative proposals for the reform of the state transfer system should reach the parliament in spring 2009[17]. The reorganisation of municipal services and structures will take place essentially through soft enforcement, stimulated by financial incentives. It is a bottom-up reform process rather than a centrally imposed one.

Currently, most progress has been made in forming larger municipal entities. The framework law sets a minimum population base requirement for municipalities of at least 20 000 people[18]. The can be considered as relatively lax, for example in Sweden the minimum population requirement is double of that. The smaller municipalities are obliged to either merge with other municipalities or alternatively form municipal partnership areas (joint municipal boards). The municipalities opting to cluster in partnership areas have the choice of structuring their service provision according to two models, either forming in cooperation new common service centres or delegating the service provision to a lead municipality. As of spring 2008, 133 municipalities have opted for the former model, 97 for the latter and 35 were yet undecided. In practice, municipalities can form cooperative arrangements with different municipalities for each of the various services they provide. This might lead to a proliferation of various forms of service provision structures, even though the number of municipalities is reduced.

As roughly one tenth of the largest municipalities account for two thirds of population and expenditure, it is not the mergers per se, but the service reforms in the biggest municipalities that will determine the overall outcome. While some concrete changes are already evident in many municipalities, in the main the service provision reforms will yet have to shift to an implementation phase. In practice this means various innovations in service provision, more effective use of ICT, possibly a greater involvement of the private and third sectors, identification and dissemination of best practices, etc. The reforms of service provision will not be centrally imposed on the local level, which might also infringe on the constitutionally granted self-governance rights of municipalities. The reforms would rather be promoted through incentives, persuasion and soft enforcement in case of lack of progress. In the same vein, the government has been cautious in setting specific measureable targets for the local governments. Given the bottom-up nature of the municipal reform and the heterogeneity of

[17] Talouspolitiikan strategia 2008, Kuntatalouden haastet (Economic Policy Strategy 2008, Challenges for Municipal Finances), Ministry of Finance.

[18] This limit applies for municipalities that provide basic healthcare and social services, a limit of 50 000 applies for municipalities organising vocational training.

service structures under formation, it would be essential to effectively monitor progress in reaching the overall goals and make timely adjustments, if necessary.

3. SUMMARY

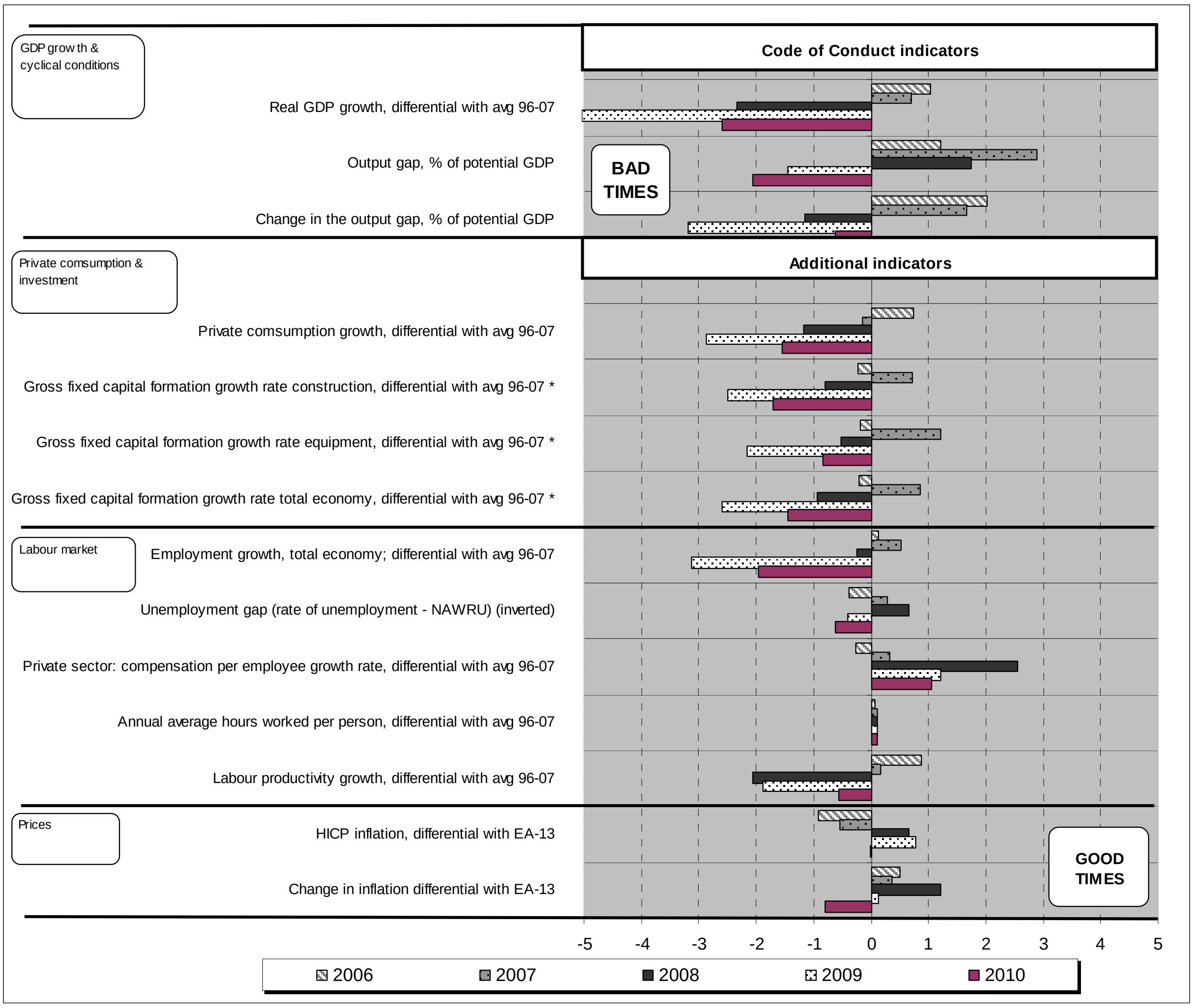
The ageing-related expenditure pressures are distributed unevenly across the government sectors, with local governments facing the strongest challenge. The adjustment should be dealt with at the local government level, even if it is likely that the direct impact on local government fiscal balances can be at least partly transferred, in effect camouflaging the challenge. In particular, the local government expenditure pressures might be relieved through a combination of higher local tax rates, increasing central government transfers, reducing quality of public services, increasing customer fees and privatisation of some services, cutting costs in some expenditure categories (for example investments). Obviously, while this avoids building up debt at the local governments, this does not solve the problem on a national scale.

Local governments are very heterogeneous, with wide differences in wealth, land area, population density and size. Some remote areas are additionally affected by the younger working-age generations relocating into growth centres. While the state transfer system is designed to equalise municipal income differences and largely covers the differences in cost bases, the ageing of the population would lead towards further divergence between the wealthier and the poorer municipalities. The weaker municipalities might face stronger pressures to raise their tax rates, leading to a widening of the dispersion of tax rates and in effect further aggravating the loss of working age population and businesses to the more competitive and less-taxed growth centres.

The heterogeneity of municipalities complicates the designing of one-size-fits-all reform solutions. The central government attempts to bring about municipal service reforms through guidance, soft enforcement and incentives, leaving the local governments a high degree of self-determination. This strategy requires close monitoring of progress, keeping in mind that the usual easily available indicators, like local government lending, can be sometimes too simplistic for identifying the underlying performance and longer term trends.

ANNEX 2. ADDITIONAL TABLES AND FIGURES

Figure 1: Good and bad economic times



* These variables have been divided by their standard deviation over the period 2003-2010, with a view to reducing their variability relative to other variables in the graph.

Source: Commission services' January 2009 forecast (COM)

Table 1: Budgetary implementation in 2008

	2007		2008	
	Planned	**Outcome**	**Planned**	**Outcome**
	SP Nov 2007	**SP Jan 2009**	**SP Nov 2007**	**SP Jan 2009**
Government balance (% of GDP)	4.5	5.3	3.7	4.4
Difference compared to target	**0.8**		**0.7**	
Of which : due to a different starting position end 2007			0.6	
due to different revenue / expenditure growth in 2008			-0.2	
p.m. Denominator effect and residual [2,3]			0.0	
p.m. Nominal GDP growth (planned and outcome)			6.0	6.3
Revenue (% of GDP)	51.9	52.6	51.0	51.4
Revenue surprise compared to target [1]	**0.7**		**0.4**	
Of which : due to a different starting position end 2007			0.7	
due to different revenue growth in 2008			-0.2	
p.m. Denominator effect [2]			-0.2	
p.m. Residual [3]			0.0	
p.m. Revenue growth rate (planned and outcome)			4.2	3.8
Expenditure (% of GDP)	47.4	47.3	47.3	47.0
Expenditure surprise compared to target [1]	**0.1**		**0.3**	
Of which : due to different starting position end 2007			0.1	
due to different expenditure growth rate in 2008			0.0	
p.m. Denominator effect [2]			0.1	
p.m. Residual [3]			0.0	
p.m. Expenditure growth rate (planned and outcome)			5.8	5.7

Notes:

[1] A positive number implies that the outcome was better (in terms of government balance) than planned.

[2] The denominator effect captures the mechanical effect that, if GDP turns out higher than planned, the ratio of revenue or expenditure to GDP will fall because of a higher denominator. Although the denominator effect can be very significant for revenue

[3] The decomposition leaves a small residual that cannot be assigned to the previous components. The residual is generally small, except in some cases where planned and actual growth rates of revenue, expenditure and GDP differ significantly.

Source : Commission services

Table 2: Evolution of budgetary targets in successive programmes

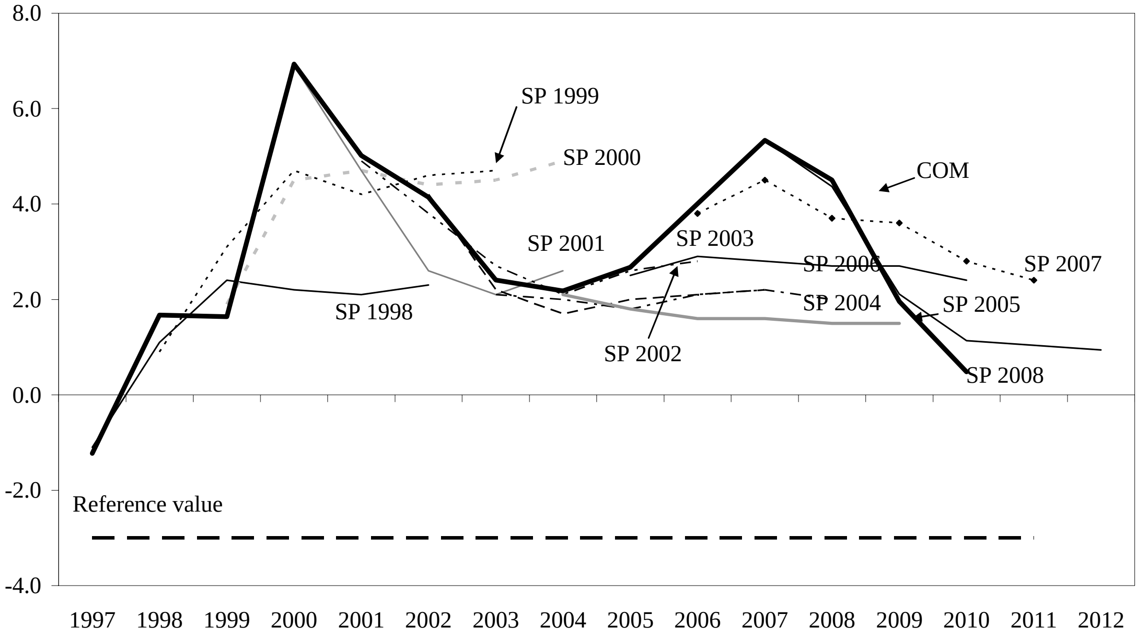
		2007	2008	2009	2010	2011	2012
General government balance (% of GDP)	**SP Jan 2009**	**5.3**	**4.4**	**2.1**	**1.1**	**1.0**	**0.9**
	SP Nov 2007	*4.5*	*3.7*	*3.6*	*2.8*	*2.4*	*n.a.*
	COM Jan 2009	5.3	4.5	2.0	0.5	n.a.	n.a.
General government expenditure (% of GDP)	**SP Jan 2009**	**47.3**	**47.0**	**48.2**	**48.6**	**48.4**	**48.5**
	SP Nov 2007	*47.4*	*47.3*	*47.0*	*47.0*	*47.2*	*n.a.*
	COM Jan 2009	47.3	47.8	50.1	50.9	n.a.	n.a.
General government revenue (% of GDP)	**SP Jan 2009**	**52.6**	**51.4**	**50.3**	**49.7**	**49.4**	**49.4**
	SP Nov 2007	*51.9*	*51.0*	*50.6*	*49.8*	*49.6*	*n.a.*
	COM Jan 2009	52.6	52.3	52.0	51.3	n.a.	n.a.
Structural balance[1] (% of GDP)	**SP Jan 2009**	**4.5**	**3.7**	**2.4**	**1.7**	**1.6**	**1.6**
	SP Nov 2007	*4.2*	*3.3*	*3.3*	*2.8*	*2.8*	*n.a.*
	COM Jan 2009	3.9	3.6	2.7	1.7	n.a.	n.a.
Real GDP (% change)	**SP Jan 2009**	**4.5**	**2.6**	**0.6**	**1.8**	**2.4**	**2.2**
	SP Nov 2007	*4.4*	*3.3*	*3.0*	*2.5*	*2.1*	*n.a.*
	COM Jan 2009	4.5	1.5	-1.2	1.2	n.a.	n.a.

Note:

[1]Cyclically-adjusted balance excluding one-off and other temporary measures. Cyclically-adjusted balances according to the programmes as recalculated by the Commission services on the basis of the information in the programmes. There are no one-off and other temporary measures in any year over the programme period according to the most recent programme. However, according to the Commission services' January interim forecast there is one deficit-increasing one-off measure of 0.2% of GDP in 2010, arising from a temporary loss of VAT revenue due to changes in the tax collection principles.

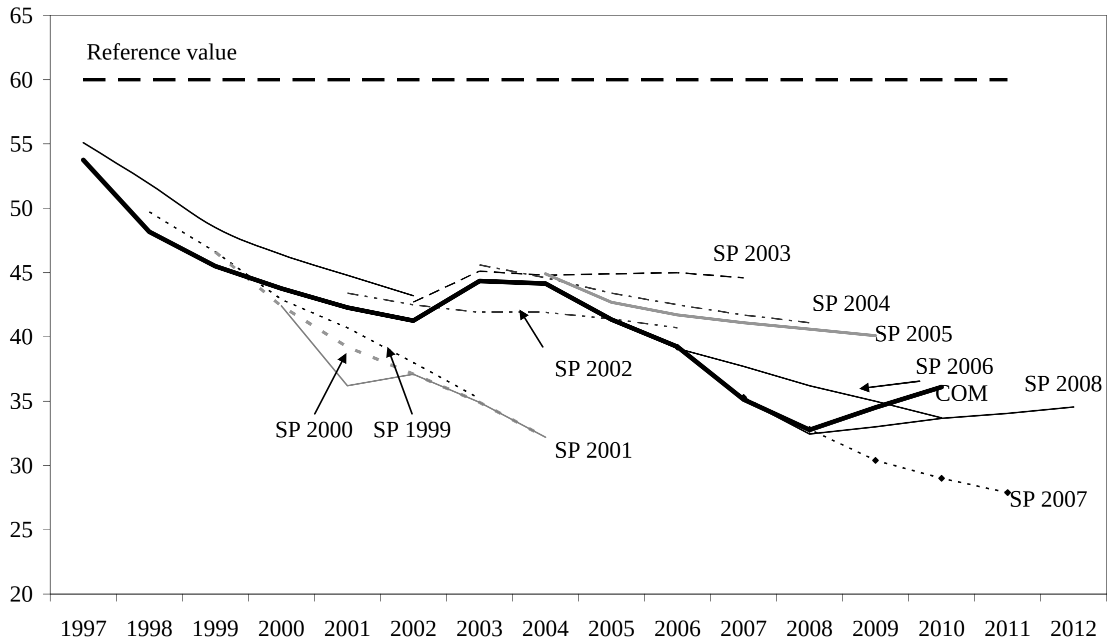
Source:
Stability programmes (SP); Commission services' January 2009 interim forecasts (COM)

Figure 2: Government balance projections in successive programmes (% of GDP)



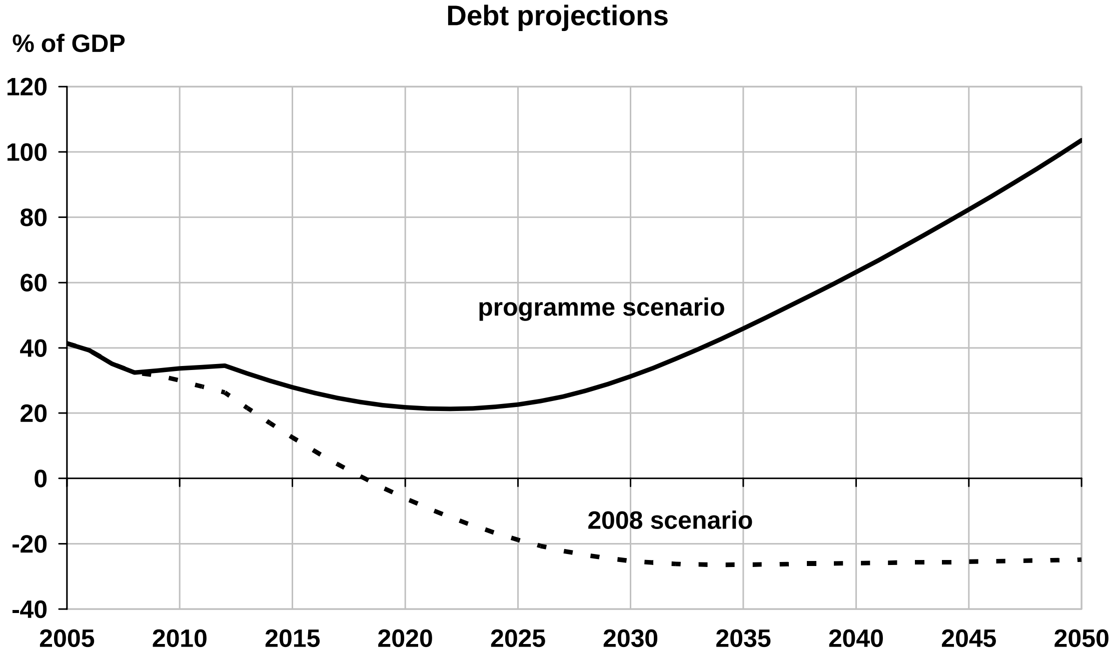
Source: Commission services' January 2009 interim forecast (COM) and successive stability programmes

Figure 3: Debt projections in successive programmes (% of GDP)



Source: Commission services' January 2009 interim forecast (COM) and successive stability programmes

Figure 4: Long-term projections for the government debt ratio



Note: Being a mechanical, partial-equilibrium analysis, the long-term debt projections are bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels should not be seen as a forecast similar to the Commission services' short-term forecasts, but as an indication of the risks faced by Member States.
Source: Commission services.

Table 3: Long-term age-related expenditure: main projections

(% of GDP)	2004	2010	2020	2030	2040	2050	Change 2010- 50
Total age-related spending	25.4	25.6	27.7	30.1	30.7	30.6	5.0
- Pensions	10.7	11.2	12.9	14.0	13.8	13.7	2.5
- Healthcare	5.6	5.8	6.2	6.6	7.0	7.0	1.2
- Long-term care	1.7	1.9	2.1	3.0	3.4	3.5	1.6
- Education	6.0	5.6	5.3	5.4	5.3	5.3	-0.3
- Unemployment benefits	1.5	1.2	1.1	1.1	1.1	1.1	-0.1
Property income received	3.2	3.2	3.1	2.7	2.4	2.2	-1.0

Source: Economic Policy Committee and Commission services.

Table 4: Sustainability indicators and the required primary balance

	2008 scenario			Programme scenario		
	S1	**S2**	**RPB**	**S1**	**S2**	**RPB**
Value	-2.5	0.1	4.7	0.1	2.5	4.8
of which:						
Initial budgetary position (IBP)	-4.3	-4.0	-	-1.9	-1.6	-
Debt requirement in 2050 (DR)	-1.5	-	-	-1.3	-	-
Long-term change in the primary balance (LTC)	3.3	4.1	-	3.3	4.1	-

Source: Commission services.

Table 5: Additional factors

	Impact on risk
Debt and pension assets	+
Decline in structural balance until 2010 in COM January 2009 interim forecast	-
Significant revenues from pension taxation	na
Alternative projection of cost of ageing	na
Strong decline in benefit ratio	na
High tax burden	na
Non-age related budgetary measures with intertemporal effect	na

Note: '-': factor tends to increase the risk to sustainability, '+': factor tends to decrease the risk to sustainability. 'na': not applicable.
Alternative projections are often presented in the programmes, whose assumptions often diverge from the common method. Projections currently discussed in the Economic Policy Committee but not yet published, are for the time being also considered "unofficial".
An explanation on these factors can be found in chapter IV of: European Commission (2006), The long-term sustainability of public finances in the European Union, European Economy No. 4/2006.
Source: Commission services.

ANNEX 3. COMPLIANCE WITH THE CODE OF CONDUCT AND TABLES FROM THE PROGRAMME

The programme broadly follows the model structure for stability and convergence programmes specified in Annex 1 of the code of conduct.

With regard to data requirements, the programme has gaps in the compulsory and optional data prescribed by the new code of conduct. Notably, the programme gives a somewhat different breakdown of expenditure components which do not directly match with the data standards of Table 2. Also, compulsory data on “one-off and other temporary measures” is not explicitly given in the tables. The external assumptions for the outer years are not provided. Optional data “liquid financial assets” specified in the Code of conduct Annex 2 Table 4 point 6 is not given for 2007-2011 in the stability programme.

Beyond the requirements of the code of conduct, the stability programme includes a breakdown of pension fund assets in Finland.

The tables on the following pages show the data presented in the December 2009 update of stability programme, following the structure of the tables in Annex 2 of the code of conduct. Compulsory data are in bold, missing data are indicated with grey-shading.

Table 1a. Macroeconomic prospects

	ESA Code	2007 Level	2007 rate of change	2008 rate of change	2009 rate of change	2010 rate of change	2011 rate of change	2012 rate of change
1. Real GDP	B1*g	*n.a.*	4.5	2.6	0.6	1.8	2.4	2.2
2. Nominal GDP	B1*g	*179.7*	7.6	6.3	2.5	3.9	4.5	4.2
Components of real GDP								
3. Private consumption expenditure	P.3	*90.6*	3.2	3.0	1.8	2.3	2.2	2.0
4. Government consumption expenditure	P.3	*38.2*	1.3	1.6	1.8	1.4	1.5	1.5
5. Gross fixed capital formation	P.51	*32.2*	8.5	2.1	-2.7	-1.5	2.6	2.1
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	*3.6*	2.0	2.8	2.5	2.5	2.5	2.5
7. Exports of goods and services	P.6	*82.2*	8.2	3.4	-0.4	4.0	5.0	4.5
8. Imports of goods and services	P.7	*73.1*	6.6	3.0	0.0	3.4	4.0	3.5
Contributions to real GDP growth								
9. Final domestic demand		-	3.6	2.3	0.8	1.2	2.0	1.8
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	-0.1	0.0	0.0	0.2	-0.1	-0.2
11. External balance of goods and services	B.11	-	1.1	0.3	-0.2	0.4	0.6	0.6

Table 1b. Price developments

	ESA Code	2007 Level	2007 rate of change	2008 rate of change	2009 rate of change	2010 rate of change	2011 rate of change	2012 rate of change
1. GDP deflator		*n.a.*	2.9	3.6	1.8	2.1	2.0	2.0
2. Private consumption deflator		*n.a.*	2.2	4.2	2.2	1.9	2.0	2.0
3. HICP[1]		*n.a.*	1.6	4.0	2.3	1.9	2.0	2.0
4. Public consumption deflator		*n.a.*	3.4	4.6	3.7	3.5	3.0	3.0
5. Investment deflator		*n.a.*	4.5	3.7	-0.9	2.0	2.0	2.0
6. Export price deflator (goods and services)		*n.a.*	0.7	1.2	-1.2	1.5	0.5	0.0
7. Import price deflator (goods and services)		*n.a.*	2.1	4.1	-2.0	1.8	1.0	1.0

[1] Optional for stability programmes.

Table 1c. Labour market developments

	ESA Code	2007	2007	2008	2009	2010	2011	2012
		Level	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
1. Employment, persons[1]		*2491.8*	2.0	1.5	-1.1	-0.2	0.2	0.1
2. Employment, hours worked[2]		*4262.2*	1.9	1.2	-1.1	-0.4	0.0	-0.1
3. Unemployment rate (%)[3]		*n.a.*	6.9	6.3	7.1	7.2	6.8	6.6
4. Labour productivity, persons[4]		*n.a.*	2.5	1.2	1.8	2.0	2.2	2.1
5. Labour productivity, hours worked[5]		*n.a.*	2.5	1.4	1.7	2.2	2.4	2.3
6. Compensation of employees	D.1	*68.4*	5.9	7.2	4.0	4.8	4.2	4.1
7. Compensation per employee		*n.a.*	3.8	5.7	5.1	5.0	4.0	4.0

[1]Occupied population, domestic concept national accounts definition.

[2]National accounts definition.

[3]Harmonised definition, Eurostat; levels.

[4]Real GDP per person employed.

[5]Real GDP per hour worked.

Table 1d. Sectoral balances

% of GDP	ESA Code	2007	2008	2009	2010	2011	2012
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	5.4	4.0	3.6	3.7	3.9	3.9
of which : - Balance on goods and services		5.1	4.0	4.0	4.2	4.4	4.4
- Balance of primary incomes and transfers		0.3	-0.1	-0.5	-0.6	-0.6	-0.6
- Capital account		0.1	0.1	0.1	0.1	0.1	0.1
2. Net lending/borrowing of the private sector	B.9	1.2	0.8	2.6	3.7	4.0	4.1
3. Net lending/borrowing of general government	EDP B.9	5.3	4.4	2.1	1.1	1.0	0.9
4. Statistical discrepancy		-1.1	n.a.	n.a.	n.a.	n.a.	n.a.

Table 2. General government budgetary prospects

	ESA Code	2007	2007	2008	2009	2010	2011	2012
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector								
1. General government	S.13	*9584*	5.3	4.4	2.1	1.1	1.0	0.9
2. Central government	S.1311	*3810*	2.1	1.2	-0.4	-1.3	-1.2	-1.2
3. State government	S.1312	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
4. Local government	S.1313	*-137*	-0.1	0.1	-0.1	-0.2	-0.2	-0.3
5. Social security funds	S.1314	*5911*	3.3	3.1	2.6	2.6	2.5	2.5
General government (S13)								
6. Total revenue	TR	*94539*	52.6	51.4	50.3	49.7	49.4	49.4
7. Total expenditure	TE[1]	*84955*	47.3	47.0	48.2	48.6	48.4	48.5
8. Net lending/borrowing	EDP B.9	*9584*	5.3	4.4	2.1	1.1	1.0	0.9
9. Interest expenditure	EDP D.41	*2605*	1.4	1.5	1.3	1.3	1.2	1.3
10. Primary balance[2]		*12189*	6.8	5.8	3.4	2.4	2.2	2.3
11. One-off and other temporary measures[3]		*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Selected components of revenue								
12. Total taxes (12=12a+12b+12c)		*55829*	30.8	30.0	29.3	28.7	28.4	28.3
12a. Taxes on production and imports	D.2	*23836*	13.0	12.7	12.7	12.2	12.0	11.9
12b. Current taxes on income, wealth, etc	D.5	*31534*	17.5	17.1	16.4	16.3	16.1	16.1
12c. Capital taxes	D.91	*459*	0.3	0.3	0.2	0.2	0.2	0.2
13. Social contributions	D.61	*21624*	12.0	11.7	11.8	12.1	12.1	12.2
14. Property income	D.4	*7788*	4.3	4.3	3.8	3.8	3.7	3.7
15. Other[4]		*9298*	5.4	5.3	5.4	5.2	5.2	5.2
16=6. Total revenue	TR	*94539*	52.6	51.4	50.3	49.7	49.4	49.4
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[5]			42.6	41.5	40.9	40.5	40.3	40.3
Selected components of expenditure								
17. Compensation of employees + intermediate consumption	D.1+P.2	*n.a.*	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
17a. Compensation of employees	D.1	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
17b. Intermediate consumption	P.2	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
18. Social payments (18=18a+18b)		*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
18b. Social transfers other than in kind	D.62	*27134*	15.1	15.0	15.6	15.9	15.9	15.9
19=9. Interest expenditure	EDP D.41	*2605*	1.4	1.5	1.3	1.3	1.2	1.3
20. Subsidies	D.3	*2197*	1.2	1.2	1.2	1.2	1.2	1.2
21. Gross fixed capital formation	P.51	*4647*	2.6	2.6	2.5	2.5	2.4	2.3
22. Other[6]		*10218*	5.7	5.5	5.7	5.6	5.6	5.5
23=7. Total expenditure	TE[1]	*84955*	47.3	47.0	48.2	48.6	48.4	48.5
p.m.: Government consumption (nominal)	P.3	*38154*	21.2	21.2	21.9	22.1	22.1	22.2

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

[2]The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

[3]A plus sign means deficit-reducing one-off measures.

[4] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

[5]Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

[6] D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

Table 3. General government expenditure by function

% of GDP	COFOG Code	**2006**	**2011**
1. General public services	1	6.5	6.1
2. Defence	2	1.5	1.3
3. Public order and safety	3	1.5	1.3
4. Economic affairs	4	4.5	4.2
5. Environmental protection	5	0.3	0.3
6. Housing and community amenities	6	0.3	0.3
7. Health	7	6.8	7.1
8. Recreation, culture and religion	8	1.1	1.1
9. Education	9	5.8	5.8
10. Social protection	10	20.4	20.8
11. Total expenditure (=item 7=23 in Table 2)	TE[1]	48.9	48.4

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

Table 4. General government debt developments

% of GDP	ESA Code	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
1. Gross debt[1]		35.1	32.4	33.0	33.7	34.1	34.6
2. Change in gross debt ratio		-4.1	-2.7	0.6	0.7	0.4	0.5
Contributions to changes in gross debt							
3. Primary balance[2]		6.8	5.8	3.4	2.4	2.2	2.3
4. Interest expenditure[3]	EDP D.41	1.4	1.5	1.3	1.3	1.2	1.3
5. Stock-flow adjustment		1.2	1.7	2.7	1.8	1.4	1.4
of which:							
- Differences between cash and accruals[4]		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Net accumulation of financial assets[5]		3.9	3.2	2.9	2.9	2.8	2.7
of which:		-	-	-	-	-	-
- privatisation proceeds		-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
- Valuation effects and other[6]		-2.7	-1.6	-0.3	-1.1	-1.4	-1.2
p.m.: Implicit interest rate on debt[7]		4.0	4.2	4.0	4.2	3.7	4.0
Other relevant variables							
6. Liquid financial assets[8]		91.1	n.a.	n.a.	n.a.	n.a.	n.a.
7. Net financial debt (7=1-6)		-56.0	n.a.	n.a.	n.a.	n.a.	n.a.

[1]As defined in Regulation 3605/93 (not an ESA concept).

[2]Cf. item 10 in Table 2.

[3]Cf. item 9 in Table 2.

[4]The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

[5]Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

[6]Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.

[7]Proxied by interest expenditure divided by the debt level of the previous year.

[8]AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

Table 5. Cyclical developments

% of GDP	ESA Code	2007	2008	2009	2010	2011	2012
1. Real GDP growth (%)		4.5	2.6	0.6	1.8	2.4	2.2
2. Net lending of general government	EDP B.9	5.3	4.4	2.1	1.1	1.0	0.9
3. Interest expenditure	EDP D.41	1.4	1.5	1.3	1.3	1.2	1.3
4. One-off and other temporary measures[1]		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
5. Potential GDP growth (%)		3.1	3.3	2.7	2.3	1.8	1.5
contributions:							
- labour		0.4	0.6	0.2	0.0	-0.3	-0.5
- capital		0.7	0.7	0.6	0.4	0.2	0.1
- total factor productivity		2.0	1.9	1.9	1.9	1.9	1.9
6. Output gap		1.5	0.9	-1.1	-1.7	-1.1	-0.4
7. Cyclical budgetary component		0.7	0.4	-0.6	-0.8	-0.5	-0.2
8. Cyclically-adjusted balance (2 - 7)		4.6	3.9	2.7	2.0	1.6	1.1
9. Cyclically-adjusted primary balance (8 + 3)		6.0	5.4	4.0	3.3	2.8	2.4
10. Structural balance (8 - 4)		4.6	3.9	2.7	2.0	1.6	1.1

[1]A plus sign means deficit-reducing one-off measures.

Table 6. Divergence from previous update

	ESA Code	2007	2008	2009	2010	2011	2012
Real GDP growth (%)							
Previous update		4.4	3.3	3.0	2.5	2.1	n.a.
Current update		4.5	2.6	0.6	1.8	2.4	2.2
Difference		0.1	-0.7	-2.4	-0.7	0.3	n.a.
General government net lending (% of GDP)	EDP B.9						
Previous update		4.5	3.7	3.6	2.8	2.4	n.a.
Current update		5.3	4.4	2.1	1.1	1.0	0.9
Difference		0.8	0.7	-1.5	-1.7	-1.4	n.a.
General government gross debt (% of GDP)							
Previous update		35.3	32.8	30.4	29.0	27.9	n.a.
Current update		35.1	32.4	33.0	33.7	34.1	34.6
Difference		-0.2	-0.4	2.4	4.5	6.0	n.a.

Table 7. Long-term sustainability of public finances

% of GDP	2000	2005	2010	2020	2030	2050
Total expenditure	n.a.	50.1	48.6	50.4	54.1	59.9
Of which: age-related expenditures	n.a.	25.0	25.6	27.6	30.2	30.7
Pension expenditure	n.a.	10.4	11.2	12.9	14.0	13.7
Social security pension	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Old-age and early pensions	n.a.	8.0	8.8	10.7	12.0	12.1
Other pensions (disability, survivors)	n.a.	2.4	2.4	2.2	2.0	1.7
Occupational pensions (if in general government)	n.a.	-	-	-	-	-
Health care	n.a.	5.5	5.8	6.2	6.6	7.0
Long-term care *(this was earlier included in the*	n.a.	1.8	1.9	2.1	3.0	3.5
Education expenditure	n.a.	5.9	5.5	5.3	5.4	5.3
Other age-related expenditures	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Interest expenditure	n.a.	1.7	1.3	1.9	3.1	8.4
Total revenue	n.a.	52.6	49.7	50.4	49.9	48.9
Of which: property income	n.a.	3.2	3.8	4.7	4.2	3.3
Of which : from pensions contributions (or social contributions if appropriate)	n.a.	9.1	9.8	10.7	11.6	11.7
Pension reserve fund assets	n.a.	62.7	68.4	75.5	71.8	59.2
Of which : consolidated public pension fund assets (assets other than government liabilities)	n.a.	51.7	57.5	63.6	60.5	49.9
Assumptions						
Labour productivity growth	n.a.	n.a.	2.2	2.1	1.7	1.7
Real GDP growth	n.a.	n.a.	1.8	1.7	1.4	1.4
Participation rate males (aged 20-64)	n.a.	n.a.	83.3	85.7	86.4	86.5
Participation rates females (aged 20-64)	n.a.	n.a.	76.6	80.3	81.5	81.9
Total participation rates (aged 20-64)	n.a.	n.a.	79.8	82.9	84.0	84.2
Unemployment rate	n.a.	n.a.	7.2	6.5	6.5	6.5
Population aged 65+ over total population	n.a.	n.a.	16.9	22.6	26.1	27.0

Table 8. Basic assumptions

	2007	2008	2009	2010	2011	2012
Short-term interest rate[1] (annual average)	4.3	4.6	3.5	4.1	n.a.	n.a.
Long-term interest rate (annual average)	4.3	4.1	4.0	4.1	n.a.	n.a.
USD/€ exchange rate (annual average) (euro area and ERM II countries)	1.37	1.48	1.36	1.36	n.a.	n.a.
Nominal effective exchange rate	2.1	3.9	-0.5	-0.1	n.a.	n.a.
(for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)	4.9	4.3	2.9	3.8	n.a.	n.a.
World excluding EU, GDP growth	2.9	1.4	0.2	1.1	n.a.	n.a.
EU GDP growth	8.7	6.4	4.0	5.1	n.a.	n.a.
Growth of relevant foreign markets	7.1	5.3	2.4	4.0	n.a.	n.a.
World import volumes, excluding EU	70.9	104.0	85.7	90.4	n.a.	n.a.
Oil prices (Brent, USD/barrel)	70.9	104.0	85.7	90.4	n.a.	n.a.

[1]If necessary, purely technical assumptions.