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COMMISSION OPINION

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.
2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING FINLAND

3. On 28 September 2015, Finland submitted an updated Stability Programme. The programme foresees the general government deficit to narrow to 1.4% of GDP in 2019, while public debt is expected to continue increasing, reaching 66.6% in 2019. The structural balance according to the programme is forecast to improve slowly and to reach a deficit of 1.4% of GDP in 2019, almost 1% of GDP above the medium-term budgetary objective (MTO) of a structural deficit of -0.5% of GDP. The updated Stability Programme incorporates the measures foreseen in the programme of the new government which took office since the submission of the no-policy-change April Stability Programme.
4. On the basis of the Draft Budgetary Plan for 2016 submitted on 28 September 2015 by Finland, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.
5. Finland is subject to the preventive arm of the Pact and should achieve a fiscal adjustment of at least 0.1 % of GDP towards the MTO in 2015 and of 0.5 % of GDP in 2016.
6. The Draft Budgetary Plan projects real GDP to grow by 1.3% in 2016, 0.6pp faster than the Commission 2015 autumn forecast. According to the Draft Budgetary Plan, the GDP deflator would increase by 0.4% in 2015 and 1.2% in 2016. Due to differences related to import price developments in 2015, the Commission projects a higher increase in the GDP deflator for 2015 (1.3%), leading to a higher nominal GDP forecast for 2015 and 2016 despite the lower real growth projection. According to the Commission 2015 autumn forecast, private consumption is expected to be weaker and the turnaround in investment activity is expected to be slower than in the Draft Budgetary Plan. Overall, the macroeconomic scenario underlying the DBP is plausible.
7. The macroeconomic forecasts underlying the Draft Budgetary Plan have been produced by the Economics Department of the Ministry of Finance. The management of the Economics department is separated from the Budget department and according to the law adopted in spring 2015, the Economics department is

independent in its forecasting activities. Finland is the only euro area Member State that has designated a Ministry of Finance department as the independent forecast producer.

8. The Draft Budgetary Plan projects the headline deficit at 3.4% of GDP in 2015, unchanged from the April Stability Programme. For 2016, the Draft Budgetary Plan targets a general government deficit of 2.8% GDP, significantly lower than the no-policy-change deficit planned in the April Stability Programme (3.2% of GDP), on the back of consolidation measures announced by the new government amounting to 0.7% of GDP. Based on the Commission 2015 autumn forecast, the deficit is projected at 3.2% of GDP in 2015 and 2.7% in 2016. The difference is explained by differences in nominal and real GDP forecasts and by more favourable tax elasticities used by the Commission. The DBP mentions some costs related to the integration of refugees over 2016-2019, but does not include a comprehensive estimate of all additional refugee-related costs in 2015 and 2016. Reflecting the partial information available at the time of the Commission forecast, a downside risk to the deficit projection is related to the inflow of refugees, which could be higher than expected.

Declining interest expenditure contributed around 0.2% of GDP to fiscal consolidation between 2012 and 2015 while the structural balance worsened by 0.6% of GDP over the same period. According to the DBP, interest expenditure is expected to contribute another 0.1% of GDP to the structural improvement in 2016. Although the low interest rate environment has a positive impact on the general government interest expenditure, there are also significant costs as Finland is a country with a large positive net asset position, both in the public and the private sector. The negative impact of the low interest environment on the income on government assets was larger than the deficit-reducing impact of lower government interest expenditure. In addition, the low interest rate and low inflation environment has a negative impact on tax revenues.

9. Finland's public debt reached 59.3% of GDP in 2014. The Draft Budgetary Plan expects the debt ratio to reach 62.6% in 2015 and 64.3% in 2016, broadly unchanged compared to the April Stability Programme and broadly in line with the Commission 2015 autumn forecast. Finland's debt ratio has been increasing due to the relatively high primary deficits but also due to the low economic growth and inflation which do not offset the interest expenditure.
10. On 16 November 2015, the Commission issued a report under Article 126(3) TFEU, as the notified deficit for 2014 and the planned deficit for 2015 provide prima facie evidence of the existence of an excessive deficit in Finland. The analysis concluded that after considering the relevant factors, both the deficit and the debt criterion should be considered as complied with.
11. The Draft Budgetary Plan for 2016 included both revenue- and expenditure-side measures. Expenditure cuts are foreseen on development cooperation, education, training and subsidies to enterprises, while benefits to households will not be indexed. On the revenue side, unemployment insurance contributions are increased by 1pp as of 2016, with a view to reduce the deficit in social security funds. The taxation of smaller incomes is reduced at the same time with tightening the taxation of higher incomes and increasing indirect taxes.
12. In its September 2015 Stability Programme Finland requests a temporary deviation of 0.5% of GDP from the required adjustment path towards the MTO in 2016 to take account of major structural reforms with a positive impact on the long-term

sustainability of public finances and a temporary deviation of 0.1% of GDP to take account of EU co-financed investments. In the absence of a sufficient safety margin to the 3% of GDP deficit reference value, Finland is currently assessed as not eligible for the requested temporary deviation in 2016.

13. In 2015, the Draft Budgetary Plan foresees a deterioration of the structural balance of 0.1% of GDP, thereby pointing to some deviation from the required adjustment of 0.1% of GDP. Over 2014-2015 taken together, the deviation becomes significant (0.5% of GDP on average) while the expenditure benchmark is met with a wide margin. The difference between the two pillars is mainly explained by the difference in the potential growth benchmarks used and the effect of lower-than-expected inflation. On the one hand, the structural balance is based on a lower estimate of medium-term potential growth rate compared to the average underlying the expenditure benchmark, with the former being more adequate given the current slow-growth macroeconomic environment. On the other hand, the expenditure benchmark better reflects the inflation expectations when the budget was prepared. On balance, the overall assessment points to a risk of some deviation from the required adjustment towards the MTO over 2014-15 taken together, which will need to be reassessed ex post taking into consideration whether the economic situation of the country in 2014 (i.e. negative real growth) justifies the observed loosening of the structural balance. Based on the Commission 2015 autumn forecast, the structural balance also points to some deviation in 2015 and to a significant deviation over 2014-2015 taken together, while the expenditure benchmark is met with a margin. Based on the same factors as mentioned above and given that the structural balance projected by the Commission is negatively affected by revenue shortfalls, the overall assessment, on balance, points to a risk of some deviation from the required adjustment towards the MTO over 2014-15 taken together.

In 2016, the Draft Budgetary Plan projects almost no change in the recalculated structural balance whereas the required adjustment is 0.5% of GDP, pointing to some deviation from the required adjustment path in 2016. Over 2015-16 taken together, the structural balance points to a significant deviation. The expenditure benchmark points to some deviation in 2016, but it continues to be met with a margin over 2015 and 2016 taken together. Therefore, an overall assessment is required. On the one hand, a temporary revenue shortfall linked to the low nominal growth environment negatively affects the structural balance. On the other hand, the potential growth rate underpinning the expenditure benchmark appears too high at the current juncture. Overall, the Draft Budgetary Plan scenario points to some deviation from the required adjustment. The Commission 2015 autumn forecast points to a 0.2% of GDP improvement in the structural balance in 2016, due to a wider output gap estimate, resulting in 0.3% of GDP deviation based on the structural balance pillar. Over two years, the deviation is 0.2% of GDP. Based on the expenditure benchmark pillar, the deviation in 2016 is -0.1% of GDP and over 2015 and 2016 taken together, the expenditure benchmark is met with a margin of 0.3% of GDP. The overall assessment based on the Commission 2015 autumn forecast takes into account that the difference in the potential growth rates used has a considerable positive effect (0.4% of GDP) on the expenditure benchmark. On that basis, the overall assessment based on the Commission 2015 autumn forecast points to a risk of some deviation from the required adjustment path towards the MTO in 2016.

14. Finland has taken some steps to reduce the labour tax wedge and to increase the growth-friendliness of taxation, in particular by adjusting the progressive income tax

scale to reflect rising earnings and inflation and by reducing the taxation of lower incomes. The revenue losses should be offset by maintaining the highest income tax bracket, while reducing the income thresholds. However, at the same time, unemployment insurance contributions are set to increase as of 2016. Therefore the overall taxation of labour is not expected to be reduced.

15. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Finland, which is currently under the preventive arm, is broadly compliant with the provisions of the Stability and Growth Pact. In particular, there is a risk of some deviation from the required adjustment towards the MTO in 2015 and 2016. The Commission invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2016 budget will be compliant with the SGP.

The Commission is also of the opinion that Finland has made limited progress with regard to the country-specific recommendations issued by the Council in the context of the 2015 European Semester relating to fiscal governance and thus invites the authorities to accelerate progress. A comprehensive assessment of progress made with the implementation of the CSRs will be made in the 2016 Country Reports and in the context of the Country Specific Recommendations adopted by the Commission in May.

Done at Brussels, 16.11.2015

*For the Commission
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Member of the Commission*