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COMMISSION STAFF WORKING DOCUMENT

Analysis of the Draft Budgetary Plan of Finland

Accompanying the document

COMMISSION OPINION

on the Draft Budgetary Plan of Finland

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1. INTRODUCTION

Finland submitted its Draft Budgetary Plan for 2020 on 7 October 2019 in compliance with Regulation (EU) No 473/2013 of the Two-Pack. Finland is subject to the preventive arm of the Pact and should ensure sufficient progress towards its medium-term budgetary objective. Finland also submitted an updated Stability Programme on 7 October 2019, which incorporates the measures foreseen in the programme of the new government that took office after the submission of the no-policy-change Stability Programme in April. The Commission assessed the Stability Programme that was submitted by the deadline of 30 April 2019.

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission 2019 autumn forecast. The following section presents the recent and planned fiscal developments, according to the Draft Budgetary Plan, including an analysis of risks to their achievement based on the Commission 2019 autumn forecast. In particular, it also includes an assessment of the measures underpinning the Draft Budgetary Plan. Section 4 assesses the recent and planned fiscal developments in 2019-2020 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. Section 5 provides an analysis of the implementation of fiscal-structural reforms in response to the latest country-specific recommendations adopted by the Council in July 2019. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

Finland is experiencing a maturing cycle, with the economy slowing down after three years of robust growth as output grew by 2.6%, 3.1% and 1.7% in 2016, 2017 and 2018, respectively. While the Stability Programme submitted in April 2019 had forecast growth to reach 1.7% in 2019 and to slow down to 1.4% in 2020, the Draft Budgetary Plan has revised growth expectations downwards to 1.5% in 2019 and 1.0% in 2020, reflecting the weakening external environment and business confidence.

According to the Commission 2019 autumn forecast, the Finnish economy is expected to grow by 1.4% in 2019 and by 1.1% in 2020. In the Commission forecast, growth is expected to be driven mainly by domestic demand, similar to the forecast that is the basis of the Draft Budgetary Plan. Private consumption is expected to continue to support growth, fuelled by the expected rise in wage income and modest increases in employment. Public consumption is set to contribute to growth more than in recent years, as the new government plans to increase spending. Investment's share in GDP growth is forecast to diminish compared to the previous period.

For 2019, the Commission forecasts a lower growth contribution from private consumption and net exports, but a higher contribution from investment compared to the Draft Budgetary Plan. For 2020, the Commission projects a lower growth of private consumption and net exports, but continues to forecast a higher growth in investment, which explains a slightly higher contribution from domestic demand and the slightly more optimistic outlook.

There are no significant differences between HICP inflation projections of the Commission and the Draft Budgetary Plan, while the GDP deflator for 2019 is somewhat lower in the Commission forecast.

Overall, the macroeconomic scenario underlying the Draft Budgetary Plan is plausible for both 2019 and 2020.

Risks to the macroeconomic scenario are tilted to the downside. In both the Commission 2019 autumn forecast and the Draft Budgetary Plan, main risks lie in the worsening external environment. Domestically, the slowdown in residential construction could turn out to be even stronger than anticipated.

Box 1. The macroeconomic forecast underpinning the budget in Finland

The macroeconomic forecast underpinning the budget has been prepared by the Economics department of the Ministry of Finance. Finland is the only euro area Member State that has designated a Ministry of Finance department as the independent forecast producer in the meaning of Regulation 473/2013 of the Two-pack. 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. According to the National Audit Office, the forecasts prepared by the Ministry of Finance are at least as reliable as are those of other national or international forecasters.

Table 1. Comparison of macroeconomic developments and forecasts

	2018	2019			2020		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	1.7	1.7	1.5	1.4	1.4	1.0	1.1
Private consumption (% change)	1.8	1.8	1.7	0.6	1.6	1.4	1.1
Gross fixed capital formation (% change)	3.3	0.5	0.4	0.7	0.8	-0.3	0.4
Exports of goods and services (% change)	2.2	3.2	2.4	1.9	2.9	2.4	2.2
Imports of goods and services (% change)	5.0	2.7	1.8	1.8	2.5	2.3	2.5
Contributions to real GDP growth:							
- Final domestic demand	2.1	1.1	1.3	1.0	1.2	1.1	1.2
- Change in inventories	0.6	0.4	0.0	0.3	0.0	0.0	0.0
- Net exports	-1.0	0.2	0.2	0.1	0.2	0.0	-0.1
Output gap[1]	0.3	0.6	0.4	0.3	0.4	0.3	0.2
Employment (% change)	2.6	1.2	0.9	0.9	0.4	0.5	0.4
Unemployment rate (%)	7.4	6.3	6.5	6.7	6.1	6.3	6.5
Labour productivity (% change)	-0.9	0.5	0.6	0.4	0.9	0.5	0.7
HICP inflation (%)	1.2	1.3	1.2	1.2	1.5	1.5	1.4
GDP deflator (% change)	2.1	1.7	1.7	1.4	2.0	1.9	1.8
Comp. of employees (per head, % change)	0.7	2.0	2.0	3.1	3.4	3.0	3.0
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-1.3	-1.4	-1.2	-1.2	-1.3	-1.3	-1.4

Note:

[1]In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:

Stability Programme 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The Draft Budgetary Plan projects a general government headline deficit of 1.0% of GDP in 2019, a significantly higher deficit than projected in the 2019 Stability Programme of 0.3% of GDP (see table 2). This deterioration of the deficit by 0.7% of GDP results from lower projected revenues (by 0.6% of GDP) and slightly higher projected expenditures (by 0.1% of GDP) in the Draft Budgetary Plan compared to the Stability Programme. It is driven by the downward revision of the macroeconomic forecast (see table 1), a higher-than-estimated deficit of the local government sector observed in the first half of the year and the general statistical revisions that deteriorated the starting fiscal position. The Commission 2019 autumn forecast predicts a general government headline deficit of 1.1% of GDP, marginally higher than the Draft Budgetary Plan. The difference between the Commission forecast and the Draft Budgetary Plan is explained mainly by the higher Commission estimation of government expenditures.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2018		2019			2020			Change: 2018-2020
	COM	DBP	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**52.2**	**52.2**	**52.3**	***51.7***	**51.9**	**52.2**	***51.7***	**52.1**	**-0.5**
of which:									
- Taxes on production and imports	14.1	14.1	13.8	*13.8*	13.9	13.6	*13.7*	13.8	-0.4
- Current taxes on income, wealth,	15.9	15.9	16.4	*16.1*	16.1	16.3	*16.3*	16.3	0.4
- Capital taxes	0.3	0.3	0.3	*0.3*	0.2	0.3	*0.3*	0.2	0.0
- Social contributions	11.9	11.9	11.8	*11.7*	11.7	12.1	*11.9*	11.9	0.0
- Other (residual)	10.0	10.0	10.0	*9.8*	9.9	9.9	*9.5*	9.8	-0.5
Expenditure	**53.1**	**53.1**	**52.6**	**52.7**	**53.0**	**52.2**	**53.1**	**53.5**	**0.0**
of which:									
- Primary expenditure	52.2	52.2	51.7	51.9	52.2	51.4	52.4	52.7	0.2
of which:									
Compensation of employees	12.3	12.3	12.2	12.2	12.3	12.1	12.4	12.5	0.1
Intermediate consumption	10.7	10.7	10.6	10.8	10.8	10.7	10.9	11.0	0.2
Social payments	21.2	21.2	21.1	21.0	21.1	21.0	21.0	21.2	-0.2
Subsidies	1.2	1.2	1.2	1.2	1.2	1.1	1.2	1.2	0.0
Gross fixed capital formation	4.2	4.2	4.1	4.2	4.2	4.0	4.3	4.3	0.1
Other (residual)	2.6	2.6	2.5	2.5	2.6	2.5	2.6	2.6	-0.1
- Interest expenditure	0.9	0.9	0.9	0.8	0.8	0.9	0.7	0.8	-0.2
General government balance (GGB)	**-0.8**	**-0.8**	**-0.3**	**-1.0**	**-1.1**	**0.0**	**-1.4**	**-1.4**	**-0.5**
Primary balance	**0.1**	**0.1**	**0.6**	**-0.2**	**-0.3**	**0.8**	**-0.6**	**-0.7**	**-0.7**
One-off and other temporary measures	-0.1	-0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.1
GGB excl. one-offs	**-0.8**	**-0.8**	**-0.4**	**-1.1**	**-1.2**	**0.0**	**-1.4**	**-1.4**	**-0.6**
Output gap[1]	0.3	0.3	0.6	0.4	0.3	0.4	0.3	0.2	0.0
Cyclically-adjusted balance[1]	-1.0	-1.0	-0.6	-1.3	-1.3	-0.3	-1.5	-1.6	-0.5
Structural balance (SB)[2]	**-1.0**	**-1.0**	**-0.8**	**-1.4**	**-1.4**	**-0.3**	**-1.5**	**-1.6**	**-0.6**
Structural primary balance[2]	-0.1	-0.1	0.1	-0.6	-0.6	0.6	-0.8	-0.8	-0.8

Notes:

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

[2] Structural (primary) balance corresponds to cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations

According to the Draft Budgetary Plan, the general government headline deficit is projected to increase further in 2020 to 1.4% of GDP. The Stability Programme prepared on a no-policy change basis by the previous government projected a balanced budget for that year. The deterioration amounting to 1.4% of GDP results from lower projected revenues (by 0.5% of GDP) and significantly higher projected expenditures (by 0.9% of GDP) in the Draft Budgetary Plan than in the Stability Programme. These large revisions are explained by a worse starting position in 2019 and the discretionary fiscal measures planned to be adopted by the current government. These measures entail scaling up spending, which are only expected to be partially covered by higher tax revenues (see section 3.3. below). According to the Draft Budgetary Plan, these expansionary plans aim at increasing employment and long-run productivity and they are to be implemented in the context of the projected continued economic slowdown. The Commission 2019 autumn forecast predicts a deficit of 1.4% of GDP, similar to the Draft Budgetary Plan.

According to the Draft Budgetary Plan and the Commission 2019 autumn forecast, risks to the fiscal outlook are tilted to the downside, mainly linked to possible spending drifts linked to the implementation of the government programme and growing expenditure related to population ageing.

Based on the information provided in the Draft Budgetary Plan, the recalculated structural balance[1] is expected to reach a deficit of 1.5% of GDP in 2020, a deterioration of 0.1 percentage points of GDP compared to a deficit of 1.4% of GDP in 2019, down from a deficit of 1% of GDP in 2018. This represents a significant downward revision with respect to the Stability Programme, which projected the 2020 recalculated structural deficit at 0.3% of GDP. The Commission 2019 autumn forecast predicts a similar deterioration of the structural balance (by 0.1% of GDP) in 2020. According to the Commission, the structural deficit is projected to be 1.6% of GDP in 2020.

Euro area sovereign bond yields remain at low levels, with 10-year rates in Finland currently standing at -0.1%.[2] As a consequence, total interest payments by the general government have continued to decrease as a share of GDP. Based on the information included in the Draft Budgetary Plan, interest expenditure in Finland is expected to fall from 0.8% in 2019 to 0.7% of GDP in 2020, well below the 1.4% of GDP recorded in 2012 at the peak of the euro area sovereign debt crisis. The picture stemming from the Draft Budgetary Plan is broadly confirmed by the Commission forecast. However, the low interest rate environment also lowers the revenues from government assets. In 2018, financial assets of the general government amounted to 126% of GDP, largely owing to the statutory pension funds that are included in the general government sector. As total general government financial liabilities amounted to 74% of GDP, the loss in revenues from government assets due to low interest rates more than outweighs the savings from general government interest payments.

Against the background of falling interest expenditure and revenue, the structural primary balance has deteriorated more than the recalculated structural balance in recent years. This is also the case in 2020, as the projected deterioration in the recalculated structural balance by 0.1 percentage point of GDP is accompanied by a deterioration in the structural primary balance estimated at 0.2 percentage points of GDP.

3.2. Debt developments

According to the revised estimate as validated by Eurostat, Finland's gross public debt was 63.0% of GDP in 2016 and declined to 59.0% of GDP in 2018. The Draft Budgetary Plan expects the debt ratio to slightly decline to 58.8% in 2019 and remain at this level in 2020. The Draft Budgetary Plan path for the debt ratio is less optimistic than that in the Stability Programme due to higher projected deficits and the economic slowdown. The Commission 2019 autumn forecast projects a slightly rising path of the debt-to-GDP ratio and projects debt at 59.2% of GDP in 2019 and 59.3% in 2020.

According to the Commission 2019 autumn forecast, Finland's debt is expected to increase due to the primary deficits but also due to some stock-flow adjustments. These adjustments are primarily related to the statutory earnings-related pension system, which is included in the

[1] Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

[2] 10-year bond yields as of 28 October 2019. Source: Bloomberg.

general government sector and is partly pre-funded.[3] The pension funds are in surplus; however, their surplus has declined over recent years due to lower interest revenues on the funds' interest-bearing assets. In 2018, the surplus was 1.2% of GDP[4] and is included in table 3 as net accumulation of financial assets under stock-flow adjustment. It increases the government debt as the surplus is not used to pay off central government or local government debt.

In 2019 and 2020, the "snow-ball" effect is decreasing the debt-to-GDP owing mainly to the growth effect and inflation effect, while interest expenditure remains relatively low.

Table 3. Debt developments

(% of GDP)	2018	2019			2020		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**59.0**	**58.1**	**58.8**	**59.2**	**57.4**	**58.8**	**59.3**
Change in the ratio	-1.8	-0.9	-0.2	0.2	-0.7	0.0	0.1
Contributions[2]:							
1. Primary balance	**-0.1**	**-0.6**	**0.2**	**0.3**	**-0.8**	**0.6**	**0.7**
2. "Snow-ball" effect	**-1.4**	**-1.1**	**-1.0**	**-0.8**	**-1.0**	**-1.0**	**-0.9**
Of which:							
Interest expenditure	0.9	0.9	0.8	0.8	0.9	0.7	0.8
Real growth effect	-1.0	-1.0	-0.9	-0.8	-0.8	-0.6	-0.6
Inflation effect	-1.3	-1.0	-1.0	-0.8	-1.1	-1.1	-1.0
3. Stock-flow adjustment	**-0.4**	**0.8**	**0.6**	**0.6**	**1.1**	**0.3**	**0.3**
Of which:							
Cash/accruals difference							
Net accumulation of financial assets							
of which privatisation proceeds							
Valuation effect & residual							

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 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations

3.3. Measures underpinning the draft budgetary plan

Table 4 A describes the main discretionary revenue measures and Table 4 B presents the main discretionary expenditure measures as reported in the Draft Budgetary Plan.

[3] Reflecting the assets of the pension funds, Finland's general government net financial assets amounted to 52% of GDP in 2018. Statistics Finland (2019) General government financial accounts.

[4] Finnish Ministry of Finance (2019) Economic Survey Autumn 2019, October 2019.

For 2019, the Draft Budgetary Plan includes mostly measures decided by the previous government. Those measures were endorsed by the current government. Regarding the government revenues, taxes on tobacco, alcoholic beverages and soft drinks are increased by an estimated EUR 207 million (0.1% of GDP) in 2019, while taxes on income increase by some EUR 133 million (0.1% of GDP), mainly thanks to the continued solidarity tax and reduction in deductibility of mortgage payments. Lower contributions for unemployment insurance and sickness insurance decided under the Competitiveness Pact are projected to decrease the revenue from social contributions by EUR 627 million (0.3% of GDP). Overall, these measures are projected to decrease government revenues by EUR 287 million (0.1% of GDP). On the expenditure side, intermediate consumption of the government is lowered by EUR 231 million (0.1% of GDP) due to the discretionary spending cuts decided by the previous government, notably in the education sector. Social payments have been reduced by EUR 228 million (0.1% of GDP), helped by falling unemployment. With the impact of other measures (EUR 133 million or 0.1% of GDP), total government expenditure has been reduced by EUR 592 million (0.2% of GDP).

From 2020 onwards, the current government has decided to pursue an expansionary fiscal policy, fostering structural reforms. The government's plans foresee a permanent increase in annual expenditure by EUR 1.1 billion (0.5% of GDP) in 2020, on top of EUR 0.1 billion planned by the previous government, further increasing expenditure to EUR 1.4 billion by 2023. The government also plans to spend a total of EUR 3.1 billion (1.3% of GDP) on 'one-off future-oriented investment' during its term (2020-2023). It should be emphasised that what the government terms 'one-off future-oriented investments' cannot be considered one-offs under the rules of the Stability and Growth Pact, as the temporary nature of these expenditures is questionable. Moreover, a relatively large share of these expenditures do not fall into the gross fixed capital formation category. Out of the total amount, EUR 0.7 billion (0.3% of GDP) is already appropriated for 2020 and EUR 0.5 billion for 2021 and 2022 while the remaining EUR 1.7 billion is planned to be spent in 2021 and 2022 conditional on the adoption by the next budget cycle of sufficient structural policy measures to raise private employment by 30.000 persons. The final decision on these conditional fiscal measures will be taken in August 2020.

Overall, the Draft Budgetary Plan foresees discretionary expenditure measures that amount in total to EUR 1.9 billion (0.8% of GDP) in 2020. Expenditure increases are expected in most categories: EUR 500 million (0.2% of GDP) in social benefits; EUR 462 million (0.2% of GDP) in fixed investment, mainly devoted to the maintenance of road network; EUR 393 million (0.2% of GDP) in intermediate consumption; EUR 300 million (0.1% of GDP) in subsidies, and EUR 197 million (0.1% of GDP) in compensation of employees. The EUR 1.9 billion expenditure increase includes EUR 0.7 billion 'one-off future-oriented investment' which is primarily targeted at subsidies (agriculture and forestry, research and innovation, transport) and education (including hiring of vocational education and training instructors and higher spending on comprehensive school and early childhood education). According to the Draft Budgetary Plan, this mix of expenditure increase is to be used to finance structural reforms improving employment and productivity, involving higher spending on education, social security reform, healthcare and investment in infrastructure.

The government plans to finance the permanent annual expenditure increase in 2020-2023 through back-loaded tax hikes, mainly excise duties, which are estimated to increase government revenue by 0.7 billion (0.3% of GDP) by 2023, but only by 0.2 billion in 2020 (0.1% GDP). The impact of the revenue measures decided by the previous government is

expected to add an additional EUR 0.2 billion revenue to the budget in 2020 (0.1% of GDP). By 2023, about EUR 0.2 billion (1.0% of GDP) in revenues is expected to be gained by reallocations within the budget, including the phasing out of the tax break for paraffinic diesel. The 'future-oriented investments' are planned to be financed by sales of state assets.

The total amount of discretionary revenue measures for 2020 included in the Draft Budgetary Plan amount to EUR 0.4 billion (0.2% of GDP). On the one hand, revenues from taxes on production and imports are expected to increase by 0.1% of GDP in 2020. The measures planned by the current government include EUR 177 million (0.1% of GDP) revenue from the excise tax hike on transport fuels, tobacco and soft drinks. Regarding current taxes on income, the measures of the 2017 Competitiveness Pact adopted by the previous government are expected to yield EUR 376 million of additional revenue from taxes on income, supplemented by EUR 109 million temporary 'solidarity tax' for high income brackets, in 2020. However, the impact of these revenue measures is expected to be partly compensated by (i) EUR 227 million negative revenue impact of a 2019 one-off measure related to a modified tax collection schedule following the introduction of a new IT system in the tax administration; as well as measures adopted by the current government: (ii) EUR 200 million tax cut for low and middle-income earners and (iii) EUR 95 million lowering of tax credit for household expenses. On the other hand, revenues from social contributions are expected to increase by EUR 280 million (0.1% of GDP) in 2020. According to the schedule decided under the Competitiveness Pact, the increased rate for social contributions for sickness insurance is planned to increase revenues, while the lowered contributions for unemployment insurance due to the low level of unemployment is planned to diminish it..

The estimates of the budgetary impact of the measures presented above appear plausible and are in line with the Commission 2019 autumn forecast.

The expenditure-revenue mismatch, cumulated for 2019 and 2020, is expected to lead to a deterioration of the general government headline deficit by 0.5% of GDP in 2020. However, the headline deterioration is not expected to lead to a proportional increase of government debt, since part of the expenditure is planned to be covered by asset sales. The government plans to achieve a balanced budget position by 2023, i.e. three years later than previously planned, through (1) the phasing out of temporary expenditure measures (1.3% of GDP); (2) the afore-mentioned tax increases (0.3% of GDP); (3) and the expected increase in income tax revenues on the back of attaining the 75% employment target, which is projected to cover the remaining gap.

Table 4. Main discretionary measures reported in the Draft Budgetary Plan

A. Discretionary measures taken by General Government - revenue side

Components	Budgetary impact (% GDP)		
	2019	**2020**	**2021**
Taxes on production and imports	0.1	0.1	0.2
Current taxes on income, wealth, etc.	0.1	0.0	0.0
Capital taxes	0.0	0.0	0.0
Social contributions	-0.3	0.1	0.0
Property Income	0.0	0.0	0.0
Other	0.0	0.0	0.0
Total	-0.1	0.2	0.1

Note:

The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that revenue increases as a consequence of this measure.

Source: Draft Budgetary Plan for 2020

B. Discretionary measures taken by General Government - expenditure side

Components	Budgetary impact (% GDP)		
	2019	**2020**	**2021**
Compensation of employees	0.0	0.1	0.0
Intermediate consumption	-0.1	0.2	0.0
Social payments	-0.1	0.2	0.0
Interest Expenditure	0.0	0.0	0.0
Subsidies	0.0	0.1	0.0
Gross fixed capital formation	0.0	0.2	0.0
Capital transfers	0.0	0.0	0.0
Other	-0.1	0.0	0.0
Total	-0.2	0.8	0.0

Note:

The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure.

Source: Draft Budgetary Plan for 2020

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Finland is subject to the preventive arm of the Pact and should ensure sufficient progress towards its medium-term budgetary objective, set at -0.5% of GDP. Box 2 reports the latest country-specific recommendations in the area of public finances.

Box 2. Council recommendations addressed to Finland

On 9 July 2019, the Council addressed recommendations to Finland in the context of the European Semester.[5] In particular, in the area of public finances the Council recommended Finland to ensure that the nominal growth rate of net primary government expenditure does not exceed 1.9 % in 2020, corresponding to an annual structural adjustment of 0.5 % of GDP.

4.1. Adjustment towards the medium-term budgetary objective

For 2019, the Council recommended Finland to respect its medium-term budgetary objective taking into account the allowed temporary deviation for implementation of structural reforms. Based on the Commission 2018 spring forecast, Finland was required to ensure that the nominal growth rate of net primary government expenditure in 2019 would not exceed 2.9%, corresponding to an allowed deterioration in the structural balance by 0.2% of GDP.

The assessment of compliance for 2019 based on the Draft Budgetary Plan points to a risk of some deviation, as both pillars point in the same direction. The expenditure benchmark points to a risk of some deviation in 2019 (gap of 0.4% of GDP). The change in the recalculated structural balance also points to a risk of some deviation in 2019 (gap of 0.2% of GDP), taking into account the temporary deviation granted related to the implementation of structural reforms.

The Commission 2019 autumn forecast confirms the conclusion of a risk of some deviation from the adjustment path towards the medium-term budgetary objective in 2019.

In 2020, Finland was recommended to ensure that the nominal growth rate of net primary government expenditure does not exceed 1.9%, corresponding to an annual structural adjustment of 0.5 % of GDP.

The assessment of compliance for 2020 based on the Draft Budgetary Plan points to a risk of significant deviation, as both indicators point in the same direction. The expenditure benchmark points to a risk of significant deviation in 2020 (gap of 0.8% of GDP). The change in the recalculated structural balance similarly indicates a risk of significant deviation in 2020 (gap of 0.6% of GDP), against the required structural improvement of 0.5% of GDP. The overall assessment also points to a risk of a significant deviation in 2019-2020 taken together, with an average gap of 0.6% of GDP and 0.4% of GDP based on the expenditure benchmark and the structural balance, respectively.

The Commission 2019 autumn forecast confirms the conclusion of a risk of significant deviation from the adjustment path towards the medium-term budgetary objective in 2020 and in 2019-2020 taken together.

[5] Council Recommendation of 9 July 2019 on the 2019 National Reform Programme of Finland and delivering a Council opinion on the 2019 Stability Programme of Finland, OJ C 301, 5.9.2019, p. 154–158.

Table 5: Compliance with the requirements of the preventive arm

(% of GDP)	2018	2019		2020	
Initial position[1]					
Medium-term budgetary objective (MTO)	-0.5	-0.5		-0.5	
Structural balance[2] (COM)	-1.0	-1.4		-1.6	
Structural balance based on freezing (COM)	-0.8	-1.0		-	
Position vis-a -vis the MTO[3]	At or above	Not at MTO		Not at MTO	
	2018	**2019**		**2020**	
(% of GDP)	**COM**	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.0	0.3		0.5	
Required adjustment corrected[5]	-0.5	-0.2		0.5	
Change in structural balance[6]	-0.3	-0.4	-0.5	-0.1	-0.1
One-year deviation from the required adjustment [7]	0.2	-0.2	-0.3	-0.6	-0.6
Two-year average deviation from the required	0.8	0.0	-0.1	-0.4	-0.5
Expenditure benchmark pillar					
Applicable reference rate[8]	2.6	2.9		1.9	
One-year deviation adjusted for one-offs [9]	-0.2	-0.4	-0.5	-0.8	-0.7
Two-year average deviation adjusted for one-offs [9]	0.4	-0.3	-0.4	-0.6	-0.6

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance corresponds to cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact ed. 2018, page 38.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2018) was carried out on the basis of Commission 2019 spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[9] Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source :

Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations.

5. COMPOSITION OF PUBLIC FINANCES AND IMPLEMENTATION OF FISCAL STRUCTURAL REFORMS

In 2015-2019, the Finnish authorities consolidated public finances mainly by reducing central government expenditure. The public wage bill came down gradually over time, in particular thanks to the measures in the 2017 Competitiveness Pact. In addition to discretionary expenditure cuts, low interest rates reduced interest expenditures. At the same time, taxes on earned income were reduced, and indirect taxes and excise duties were increased. Falling tax revenues and falling property income of the pension funds offset the structural improvement on the expenditure side.

With the current government taking office in June 2019, the Finnish authorities decided to pursue expansionary policy in the short term, with a view to finance the 'future-oriented investments' and structural reforms in the medium term, which are also projected to improve

fiscal sustainability in the long term. A part of the planned increase in spending in 2020 is directed to labour market reforms, investment in education and health care, as well as transport infrastructure maintenance. These expenditures as well as the projected deterioration of the baseline due to ageing-related expenditures, are not expected to be fully financed by revenue measures. However, the government assumes that by the end of its mandate the adopted structural reforms will create a minimum of 60 000 new jobs thus generating additional revenues for the government and allowing to balance the budget in 2023. The 'future oriented investments' are also planned to be financed by sale of the government assets. Overall, more measures will need to be adopted in order to meet the government's defined spending ceilings for the outer years.

Regarding the adopted revenue measures for 2020, the government decided to continue the gradual tax shift away from taxation of earned income, favouring low-middle income earners (lowering personal income taxes for those groups by EUR 200 million), towards indirect taxes on items such as energy and transport fuels (EUR 104 million hike), tobacco (EUR 50 million hike), alcohol and soft drinks (EUR 25 million hike). The tax base is expected to be strengthened by phasing out during the parliamentary term the right to deduct interest on home loans (additional revenue of EUR 28 million). The domestic work credit is also planned to be reduced (additional revenue of EUR 95 million) in 2020. The temporary solidarity tax for high income brackets is expected to be maintained (revenue of EUR 100 million) in 2020.

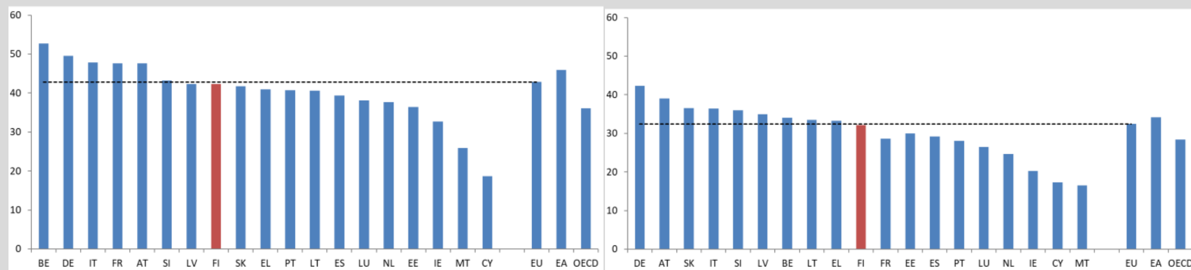
The Draft Budgetary Plan and the attached General Government Fiscal Plan for 2020-2023 include appropriations proposing the carbon neutrality targets, such as wellbeing of the environment and biodiversity, reducing emissions, supporting renewable energy and public transport. A tax reform for sustainable development is planned to be prepared in 2020-2023, covering energy taxation, transport taxation, promotion of the circular economy and a study of emissions-based consumption taxation. In 2020, taxes on traffic fuels are expected to be raised but at the same time a reduction of motor vehicle tax decided by the previous government is planned to kick in (reducing revenue by EUR 50 million).

Box 3. Addressing the tax burden on labour in the euro area

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. Against this background, the Eurogroup has expressed a commitment to reduce the tax burden on labour. On 12 September 2015, the Eurogroup agreed to benchmark euro area Member States' tax burden on labour against the GDP-weighted EU average, relying in the first instance on indicators measuring the tax wedge on labour for a single worker at average wage and a single worker at low wage. It also agreed to relate these numbers to the OECD average for purposes of broader comparability.

The tax wedge on labour measures the difference between the total labour costs to employ a worker and the worker’s net earnings. It is made up of personal income taxes and employer and employee social security contributions. The higher the tax wedge, the higher the disincentives to take up work or hire new staff. The graphs below show the tax wedge in Finland for a single worker earning respectively the average wage and a low wage (50% of the average) compared to the EU average.

The tax burden on labour in Finland at the average wage and at low wage (2018)



Notes: EU and EA averages are GDP-weighted. The OECD average is not weighted.
Source: European Commission Tax and Benefit Indicator database based on OECD data.

Benchmarking is only the first step in the process towards firm, country-specific policy conclusions. The tax burden on labour interacts with a wide variety of other policy elements such as the benefit system and the wage-setting system. A good employment performance indicates that the need to reduce labour taxation may be less urgent while fiscal constraints can dictate that labour tax cuts should be fully offset by other revenue-enhancing or expenditure-reducing measures. In-depth, country-specific analysis is necessary before drawing policy conclusions.

Finland's Draft Budgetary Plan contains the following measures that affect the tax wedge on labour: reduction of personal income tax and changes to social security contributions (see Table 4). Part of the measures follow from the Competitiveness Pact which came in force in 2017 (see the more detailed discussion in the staff working document[1] of the Draft Budgetary Plan for 2017). According to the Pact, contributions for sickness insurance were temporarily lowered in 2017 and this reduction is going to be partially reverted in 2020, by increasing the rate by 0.3 percentage points for employees and 0.6 percentage points for employers. On the other hand, unemployment insurance contributions will be further reduced by 0.3 percentage points as of 2020 (following the reduction by 0.4 percentage points in 2019) as the number of unemployed is projected to continue to decrease. Overall, total social contributions as government revenue are planned to increase by EUR 280 million (0.1% of GDP) in 2020. The current government decided to lower personal income tax by EUR 200 million in 2020 for low and middle income earners to compensate for increases in indirect taxes. At the same time, the temporary solidarity tax for high income brackets is expected to be maintained, expected to bring revenue of EUR 100 million in 2020. As customary, the government will also adjust the central government labour income tax-brackets according to expected increases in wages in 2019 and 2020. Overall, the measures in the Draft Budgetary Plan are slightly increasing the tax wedge on labour.

[1] C(2016) 8006 final

For 2020, the Council's fiscal-structural recommendation invited Finland to improve the cost-effectiveness of and equal access to social and healthcare services. The ageing population and the rising age-related expenditure remain concerns for the long-term sustainability of the Finnish public finances. The administrative reform and the reform of the social and healthcare services (SOTE) were not approved by Parliament in due time in March 2019 due to constitutional concerns, leading to an early resignation of the previous government. The current government has pledged to pursue the reform plans aimed at reducing expenditure growth in healthcare and ensuring equal access to health and social services, taking into

account the work done during previous parliamentary terms and with a stronger emphasis on equal access to and quality of services. The Draft Budgetary Plan includes some appropriations in the budget of the Ministry of Social Affairs and Health and of municipalities for improving access to health and social services. Preparations for the administrative reform introducing 18 counties have started with a study on special arrangements for Uusimaa, the Helsinki Metropolitan Area, due by end of 2019. The reform is planned to be implemented during the government's term, with all elements of legislation expected to be adopted by spring 2023. No reliable study has been issued so far on the possible cost savings from the considered social and healthcare services reform.

The 2017 Draft Budgetary Plan presented a formal request to avail of the flexibility available under the preventive arm for 2017 in view of the planned implementation of major structural reforms, in particular the pension reform and the Competitiveness Pact, with a positive impact on the long-term sustainability of public finances. The aim of the Pact was to reduce labour costs to employers to regain cost competitiveness by reducing employers' contributions to social security, by freezing wages for 12 months, and by increasing annual working time without additional compensation. In the public sector, the annual holiday bonus was temporarily lowered by 30% in 2017-2019. The costs of the structural reforms were estimated at 0.6% of GDP. A Member State that is at, or close to, its medium-term budgetary objective is allowed to depart from it for three years and therefore the flexibility granted in a given year is carried forward for the next two years. This is the case of Finland, for which the allowed deviation from the medium-term budgetary objective amounts 0.5% of GDP in 2019, the last year of validity of the clause.

6. OVERALL CONCLUSION

Finland's debt-to-GDP ratio is projected to remain below the 60% reference value in 2019 and 2020.

Based on both the information contained in the Draft Budgetary Plan and the Commission 2019 autumn forecast, there is a risk of some deviation from the required adjustment path towards the medium-term budgetary objective in 2019 and a risk of significant deviation from the required adjustment path towards the medium-term budgetary objective in 2020 and in 2019 and 2020 taken together.