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Assessment of the 2019 Stability Programme for

Finland

(Note prepared by DG ECFIN staff)

CONTENTS

EXECUTIVE SUMMARY

Finland is subject to the preventive arm of the Stability and Growth Pact. With a gross public debt below 60% of GDP, Finland is compliant with the debt criterion. Finland is expected to remain at its adjusted medium-term budgetary objective (MTO) in 2019 and close to its MTO in 2020. At the same time, based on the Stability Programme, the expenditure benchmark would currently point to a risk of a significant deviation from the requirement in 2018 and 2019 taken together as well as in 2019 and 2020 taken together. If compliance with the MTO, taking into account the allowance linked to implementation of structural reforms, can no longer be established in future assessments, an overall assessment would need to take into account a possible deviation from the requirement. Overall, Finland is expected to remain compliant with the MTO in 2019 and to be broadly compliant in 2020.

The Finnish economy expanded by 2.3% in 2018 in real terms, but economic growth is expected to slow down to 1.6% in 2019 and 1.2% 2020, according to the Commission 2019 spring forecast. Private consumption is expected to remain the main driver of growth this year and next, thanks to the expected rise in household labour and non-labour income, and still solid levels of consumer confidence. With a short-term growth outlook around the level of potential growth, the output gap is forecast to remain positive at 0.9% of potential GDP. Employment growth, at 2.7%, was exceptionally strong in 2018. Although unlikely to match last year's performance, the employment outlook for 2019 and 2020 is positive. As the unemployment rate approaches its structural level, supply-side constraints are expected to emerge, fuelling wage growth. Inflation is forecast to increase but should remain below 2%. The macro-economic scenario included in the Stability Programme is plausible.

In 2018, the headline general government balance reached -0.7% of GDP. According to the Stability Programme, the general government balance is set to improve to -0.3% of GDP in 2019 and 0.0% in 2020, before deteriorating again to -0.1% in 2021 and -0.3% by 2022. In structural terms, based on recalculated output gaps, the budget balance of -1.0% of potential GDP in 2018 overachieved the medium-term budgetary objective (set at -0.5% of GDP) adjusted for the allowances totalling 0.67% of GDP that were granted under the structural reform clause (0.5% of GDP) and the unusual events clause (0.17% of GDP). The structural balance is expected to remain unchanged at -1.0% of potential GDP in 2019, before increasing to -0.6% in 2020. Risks to the short-term fiscal outlook mainly come from the macroeconomic side, such as a worsening of the economic climate or lower-than-projected wage growth, which would affect income tax revenue. The projected increase in public expenditure on health and long-term care points to medium risks for long-term debt sustainability.

1. INTRODUCTION

On 4 April 2019[1], Finland submitted its 2019 Stability Programme (hereafter called Stability Programme), covering the period 2019-2022, together with the General Government Fiscal Plan 2020-2023, including the central government spending limits and a limit for local government expenditure.

Finland is currently subject to the preventive arm of the Stability and Growth Pact (SGP) and should preserve a sound fiscal position that ensures compliance with the medium-term budgetary objective (MTO).

This document complements the Country Report published on 27 February 2019 and updates it with the information included in the Stability Programme.

Section 2 presents the macroeconomic outlook underlying the Stability Programme and provides an assessment based on the Commission 2019 spring forecast. The following section presents the recent and planned budgetary developments, according to the Stability Programme. In particular, it includes an overview on the medium-term budgetary plans, an assessment of the measures underpinning the Stability Programme and a risk analysis of the budgetary plans based on the Commission forecast. Section 4 assesses compliance with the rules of the SGP, including on the basis of the Commission forecast. Section 5 provides an overview on long-term sustainability risks and Section 6 on recent developments and plans regarding the fiscal framework. Section 7 provides a summary.

2. MACROECONOMIC DEVELOPMENTS

The macroeconomic scenario underlying the Stability Programme is based on the Economic Survey Spring 2019, which was published by the Finnish Ministry of Finance in parallel to the Stability Programme. Real GDP growth is forecast to decrease from 2.3% in 2018 to 1.7% in 2019 and 1.4% in 2020. The Stability Programme projects the continuation of this trend also in 2021 (1.2%) and 2022 (1.0%).

Real GDP growth in 2018 turned out worse than the 3.0% expected in the macroeconomic projections underpinning the 2019 Draft Budgetary Plan submitted in October 2018, based on the Finnish Economic Survey Autumn 2018. Lower growth was mainly due driven by an unexpected slowdown in investment and net exports, especially in the third quarter. Besides, GDP growth in the first quarter was also revised down. Regarding 2019, the Stability Programme maintained the 1.7% growth rate projected in the Draft Budgetary Plan, which was fairly conservative at the time. For comparison, the Commission 2018 autumn forecast projected economic growth in 2019 at 2.2%.

The Commission 2019 spring forecast has a slightly less optimistic scenario than the Stability Programme. It forecasts real GDP to grow at 1.6% in 2019 and 1.2% in 2020. The difference is driven mainly by lower private consumption growth in both years. That effect is partially compensated by higher estimated investment and higher contribution of net exports in 2019 in the Commission forecast.

Both the Commission forecast and the Stability Programme assume the continuation of positive trends in the labour market, with increasing employment, decreasing unemployment

[1] The official English translation was submitted on 16 April 2019.

and relatively strong growth of compensation of employees. Assumptions on inflation are similar, pointing to gradual increases in the inflation rate in 2019 and 2020.

The output gaps as recalculated by the Commission based on the information in the programme, following the commonly agreed methodology, are positive (0.6% in 2019 and 0.4% in 2020) and gradually closing over time. The output gaps in the Commission forecast are generally higher (0.9% in 2019, 0.8% in 2020), which results from projected lower potential growth.

The Stability Programme appears to be based on plausible macroeconomic assumptions, which are broadly consistent with the assumption of the Commission 2019 spring forecast.

Table 1: Comparison of macroeconomic developments and forecasts

	2018		2019		2020		2021	2022
	COM	**SP**	**COM**	**SP**	**COM**	**SP**	**SP**	**SP**
Real GDP (% change)	2.3	2.3	1.6	1.7	1.2	1.4	1.2	1.0
Private consumption (% change)	1.4	1.4	1.6	1.8	1.4	1.6	1.6	1.1
Gross fixed capital formation (% change)	3.2	3.2	1.6	0.5	1.3	0.8	0.6	1.1
Exports of goods and services (% change)	1.5	1.5	3.2	3.2	3.4	2.9	2.0	1.5
Imports of goods and services (% change)	4.2	4.2	2.2	2.7	3.2	2.5	1.9	1.5
Contributions to real GDP growth:								
- Final domestic demand	1.8	1.8	1.5	1.1	1.1	1.2	1.1	1.0
- Change in inventories	0.4	1.6	-0.2	0.4	0.0	0.0	0.0	0.0
- Net exports	-1.0	-1.0	0.4	0.2	0.1	0.2	0.0	0.0
Output gap[1]	0.7	0.5	0.9	0.6	0.8	0.4	0.5	0.5
Employment (% change)	2.7	2.7	0.9	1.2	0.6	0.4	0.3	-0.2
Unemployment rate (%)	7.4	7.4	6.7	6.3	6.2	6.1	6.0	6.1
Labour productivity (% change)	-0.3	-0.4	0.8	0.5	0.6	0.9	0.9	1.2
HICP inflation (%)	1.2	1.2	1.4	1.3	1.6	1.5	1.7	1.8
GDP deflator (% change)	1.9	1.9	1.5	1.7	1.9	2.0	2.0	1.9
Comp. of employees (per head, % change)	1.2	1.4	3.4	2.0	2.9	3.4	3.0	3.0
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-1.8	-1.8	-1.4	-1.4	-1.3	-1.3	-1.2	-1.2

Note:

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

Source :

Commission 2019 spring forecast (COM); Stability Programme (SP).

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. DEFICIT DEVELOPMENTS IN 2018 AND 2019

In 2018, the general government balance improved slightly to -0.7% of GDP, from -0.8% in 2017. The outturn exceeded the projection for 2018 presented in the Draft Budgetary Plan for 2018 (-1.4% of GDP). The overachievement was due to a better balance of the central government and a higher surplus of the social security funds than initially projected, which was only partly offset by the worse-than-expected balance of the local government. The latter was caused primarily by a rapid increase in expenditure related to the costs of ageing; preparations for the regional government, health and social services reform; rising wages of local government employees and investment projects. The increase in the surplus of social security funds was owed to substantial increases in property and dividend income as well as high inflows of pension contributions linked to a better employment situation. Factors supporting the better balance of the central government are outlined in the paragraph below.

In 2018, at 52.5% of GDP, total government revenue outperformed expectations. The 2018 Draft Budgetary Plan projected the revenue-to-GDP ratio at 51.7% of GDP (for the fiscal year of 2018), albeit related to a higher projected nominal GDP. The growth of revenues was mainly driven by the growth of taxes on production and imports (5.0%) that exceed the growth of the nominal GDP (4.3%), while income tax growth remained rather modest following cuts in wage income taxes and social contributions in accordance with the Competitiveness Pact. Total government expenditure at 53.1% of GDP was in line with the projections if the 2018 Draft Budgetary Plan, pointing to lower-than-budgeted expenditure in nominal terms as nominal GDP turned out lower than expected.

For 2019, the Stability Programme forecasts the general government balance to improve to -0.3% of GDP. Both total revenue and expenditure are projected to increase by less than nominal GDP and therefore their shares in GDP would decrease slightly. The revenue ratio is projected at 52.3% and the expenditure ratio at 52.6% of GDP. While direct taxes are expected to increase relative to GDP on the back of strong profit and wage growth, other revenue components, i.e. indirect taxes, contributions to social security are projected to decrease. Almost all expenditure categories contribute to the fall of 0.5 percentage points of the expenditure ratio.

In 2019, owing to the finalisation of an IT-system update at the Tax Authority, tax revenues from households are projected to increase by an additional EUR 250 million (0.1% of GDP). The new system allows an earlier settlement of income taxation of the preceding year and therefore this increase in government revenues is considered a one-off measure.

The Draft Budgetary Plan for 2019 foresaw a headline balance target of -0.1% of GDP, representing an improvement by 0.6% of GDP. The Stability Programme expects a lower headline balance at -0.3% of GDP. Both revenues and expenditures were revised upwards in the Stability Programme, with a higher relative increase on the expenditure side. Compared to the Draft Budgetary Plan, the Stability Programme projects higher spending on compensation of employees (by 0.3% of GDP) and on investment (by 0.3% of GDP).

3.2. MEDIUM-TERM STRATEGY AND TARGETS

The Stability Programme presents a fiscal forecast until 2022. The projections for 2020-2022 are based on a no-policy-change assumption since the general elections in April 2019 were held soon after the submission of the Stability Programme. The Stability Programme recalls that Finland has set its MTO for the structural balance to -0.5% of GDP and that the government is committed to achieving the MTO by 2019. According to the Commission's assessment, the MTO reflects the objectives of the Pact. In spring 2019, the Commission has published the updated minimum benchmarks for the MTO for the 2020-2022 period. Taking the minimum benchmark update into account, the new government to be formed following the parliamentary elections is expected to define Finland's new MTO in its first General Government Fiscal Plan.

The Programme forecasts a balanced headline general government budget in 2020 (0.0% of GDP). Based on a no-policy-change scenario, all previously adopted consolidation measures are expected to be fully implemented by then. The main trends underlying government revenues and expenditures are expected to continue. Revenue is expected to grow in line with nominal GDP, supported mainly by domestic consumption. Government spending is expected to remain moderate, observing the spending limits. The Commission 2019 spring forecast projects a slight headline deficit for 2020 (0.2% of GDP), which is due to a somewhat more pessimistic macroeconomic outlook leading to lower government revenues.

For 2021-2022, the Stability Programme expects the economy to slow down further, reducing tax revenues. On the expenditure side, in the absence of structural reforms, ageing costs are projected to force higher spending on health and long-term care. Therefore, the budget balance is projected to continue deteriorating, to -0.1% of GDP in 2021 and -0.3% of GDP in 2022.

According to the Stability Programme, with the structural balance at -0.7% of GDP, Finland was close to its MTO in 2018 and is projected to stay at the same level in 2019. In 2020, the Stability Programme projects the structural balance to stand at -0.3% of GDP, which is above the current MTO. In 2021, the structural balance would decrease to -0.4% of GDP and in 2022 to -0.6%, along with the headline balance. The structural balance, as recalculated by the Commission on the basis of the information in the Stability Programme according to the commonly agreed methodology, follows a similar track. It is projected to improve from -1.0% in 2018 to -0.7% in 2019 and -0.3% in 2020. It should remain at -0.3% in 2021 and lower to -0.6% in 2022.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2018	2019		2020		2021	2022	Change: 2018-2022
	COM	**COM**	**SP**	**COM**	**SP**	**SP**	**SP**	**SP**
Revenue	**52.5**	**52.5**	**52.3**	**52.4**	**52.2**	**52.0**	**51.9**	**-0.6**
of which:								
- Taxes on production and imports	14.2	14.0	13.8	13.8	13.6	13.5	13.3	-0.8
- Current taxes on income, wealth, etc.	16.0	16.2	16.4	16.2	16.3	16.5	16.5	0.5
- Social contributions	12.0	11.9	11.8	12.1	12.1	11.9	11.9	-0.1
- Other (residual)	10.3	10.3	10.3	10.2	10.2	10.1	10.2	-0.2
Expenditure	**53.1**	**52.8**	**52.6**	**52.6**	**52.2**	**52.0**	**52.2**	**-0.9**
of which:								
- Primary expenditure	52.3	52.0	51.7	51.7	51.4	51.2	51.3	-0.9
of which:								
Compensation of employees	12.3	12.2	12.2	12.2	12.1	n.a.	n.a.	n.a.
Intermediate consumption	10.7	10.7	10.6	10.7	10.7	n.a.	n.a.	n.a.
Social payments	21.3	21.2	21.1	21.1	21.0	20.9	21.0	-0.3
Subsidies	1.2	1.2	1.2	1.1	1.1	1.1	1.1	-0.1
Gross fixed capital formation	4.2	4.2	4.1	4.2	4.0	3.8	3.9	-0.3
Other (residual)	2.6	2.5	2.5	2.5	2.5	2.5	2.5	-0.1
- Interest expenditure	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.0
General government balance (GGB)	**-0.7**	**-0.4**	**-0.3**	**-0.2**	**0.0**	**-0.1**	**-0.3**	**0.3**
Primary balance	**0.2**	**0.5**	**0.6**	**0.7**	**0.8**	**0.8**	**0.6**	**0.3**
One-off and other temporary	-0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.1
GGB excl. one-offs	**-0.6**	**-0.5**	**-0.4**	**-0.2**	**0.0**	**-0.1**	**-0.3**	**0.2**
Output gap[1]	0.7	0.9	0.6	0.8	0.4	0.5	0.5	-0.1
Cyclically-adjusted balance[1]	-1.1	-0.9	-0.6	-0.6	-0.3	-0.4	-0.6	0.4
Structural balance[2]	**-1.0**	**-1.0**	**-0.7**	**-0.6**	**-0.3**	**-0.4**	**-0.6**	**0.3**
Structural primary balance[2]	-0.1	-0.1	0.1	0.2	0.6	0.5	0.3	0.4

Notes:

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

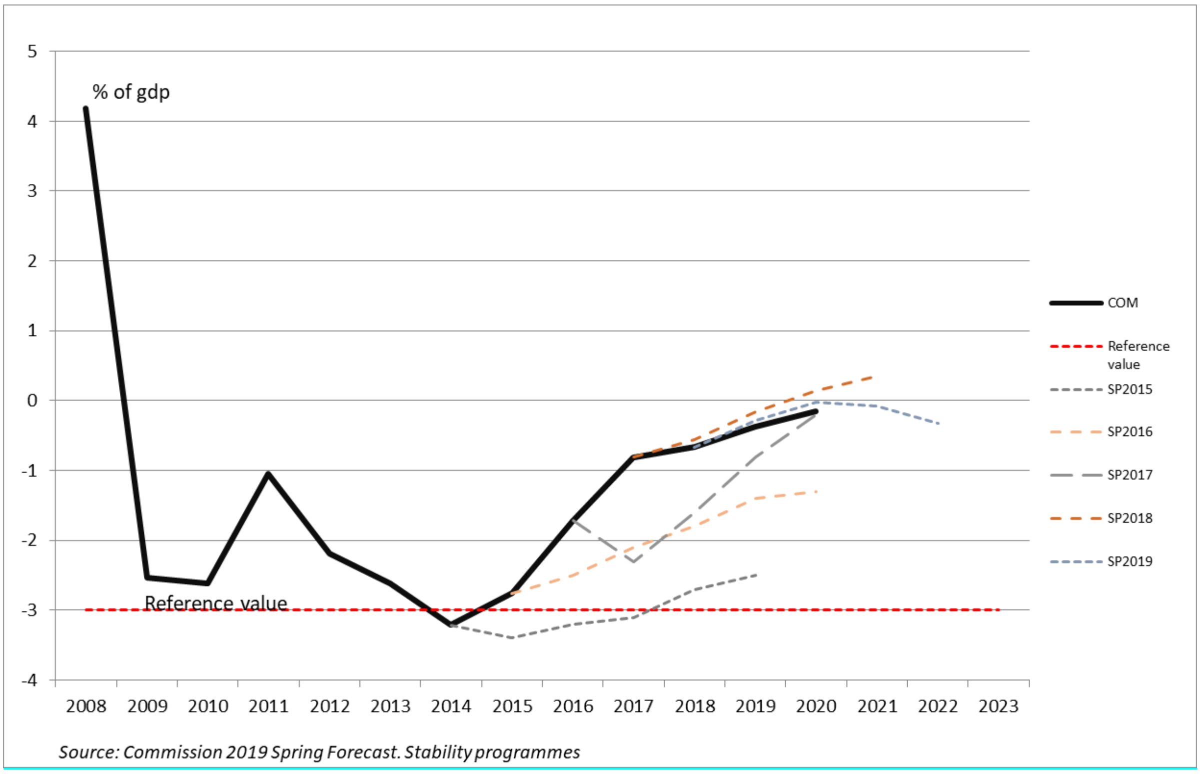
[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source :

Stability Programme (SP); Commission 2019 spring forecasts (COM); Commission calculations.

Figure 1 presents the balance projections of the recent Stability Programmes.

Figure 1: Government balance projections in successive programmes (% of GDP)



3.3. MEASURES UNDERPINNING THE PROGRAMME

The Stability Programme is based on a no-policy-change scenario and does not contain new measures to achieve the previously set fiscal targets compared to the Draft Budgetary Plan for 2019. The table below presents the annual net fiscal impact over 2018-2023 of the main revenue and expenditure measures decided by the government in years 2015-2019.

In line with Prime Minister Sipilä's Government's Programme of 2015, the government decided to reduce public spending by about 2% of GDP between 2016 and 2019. Measures to achieve these savings included a freeze and a reduction of the CPI-indexation of social transfers (excluding means-tested social assistance) and savings in expenditures on all the main government functions with the exception of defence spending. In 2019, expenditure on the priority projects of the current government, such as certain transport investment, will come to an end, which should improve the balance further. Over the same period, on the revenue side, the outgoing government reduced taxes on labour income and contributions to social security, in particular in accordance with the Competitiveness Pact, which was agreed between the social partners in 2016 with a view to improving Finland's cost competitiveness in a stepwise manner over the period 2017 to 2020; hence, under unchanged policies, this agreement will keep affecting revenues over the horizon of the Stability Programme. To offset the negative impact of these measures on tax revenues, indirect taxation such as recurring tax on real estate, energy taxes and excise duties on alcohol and cigarettes were increased, thereby shifting the emphasis of taxation gradually away from less growth-friendly tax bases.

Main budgetary measures included in the Programme

Revenue	Expenditure
2018	
• Reduction of income taxes (-0.3% of GDP) • Changes to rate of social security contributions (-0.2% of GDP)	• Expenditure cuts, net (-0.2% of GDP)
2019	
• Reduction of wage income taxes (-0.1% of GDP) • Changes to rate of social security contributions (-0.3% of GDP)	• Expenditure cuts, net (-0.2% of GDP)
2020	
• Reduction of wage income taxes (-0.2% of GDP) • Changes to rate of social security contributions (0.3% of GDP)	
2021-2023	
• Reduction of wage income taxes (-0.2% of GDP per year) • Changes to rate of social security contributions (-0.2% of GDP in 2021)	• Increase in appropriations for transport infrastructure maintenance (0.1% of GDP in 2021)

Note: The table refers to the main measures included in the General Government Fiscal Plan 2020-2023, which includes the 2019 Stability Programme as annex, that have a fiscal impact over the programme period. The budgetary impact in the table is the incremental annual impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.

The Stability Programme does not quantify the impact of the measures on the general government headline balance, but as the Programme is an annex to the General Government Fiscal Plan, some details of above-mentioned measures can be found in section 8 of the Fiscal Plan.

3.4. DEBT DEVELOPMENTS

The general government gross debt-to-GDP ratio doubled from a very low base during and after the economic crisis, but has been on a declining path since 2015. The debt ratio was at 58.9% of GDP in 2018 and is projected to decline to 58.1% of GDP in 2019 and 57.4% in

2020 according to the Stability Programme. For the outer years, the Stability Programme projects the debt-to-GDP ratio to bottom out at 57.4% in 2021 before slightly increasing to 57.7% in 2022. The declining path for the debt ratio until 2021 is similar to the one presented a year earlier in the 2018 Stability Programme, where the debt ratio was projected to decline to 60.4% in 2018 and 56.7% by 2021. Similarly, the Commission 2019 spring forecast expects a decreasing debt ratio in 2019 and 2020, albeit at a slower pace.

Table 3: Debt developments

(% of GDP)	Average 2013-2017	2018	2019		2020		2021	2022
			COM	SP	COM	SP	SP	SP
Gross debt ratio[1]	**60.9**	**58.9**	**58.3**	**58.1**	**57.7**	**57.4**	**57.4**	**57.7**
Change in the ratio	1.5	-2.4	-0.6	-0.8	-0.6	-0.7	0.0	0.3
Contributions[2]:								
1. Primary balance	**1.1**	**-0.2**	**-0.5**	**-0.6**	**-0.7**	**-0.8**	**-0.8**	**-0.6**
2. "Snow-ball" effect	**-0.2**	**-1.6**	**-0.9**	**-1.1**	**-0.9**	**-1.0**	**-0.9**	**-0.7**
Of which:								
Interest expenditure	1.1	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Growth effect	-0.6	-1.4	-0.9	-1.0	-0.7	-0.8	-0.6	-0.5
Inflation effect	-0.8	-1.1	-0.8	-1.0	-1.1	-1.1	-1.1	-1.1
3. Stock-flow adjustment	**0.6**	**-0.6**	**0.8**	**0.9**	**1.0**	**1.1**	**1.7**	**1.6**
Of which:								
Cash/accruals diff.								
Acc. financial assets								
Privatisation								
Val. 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.

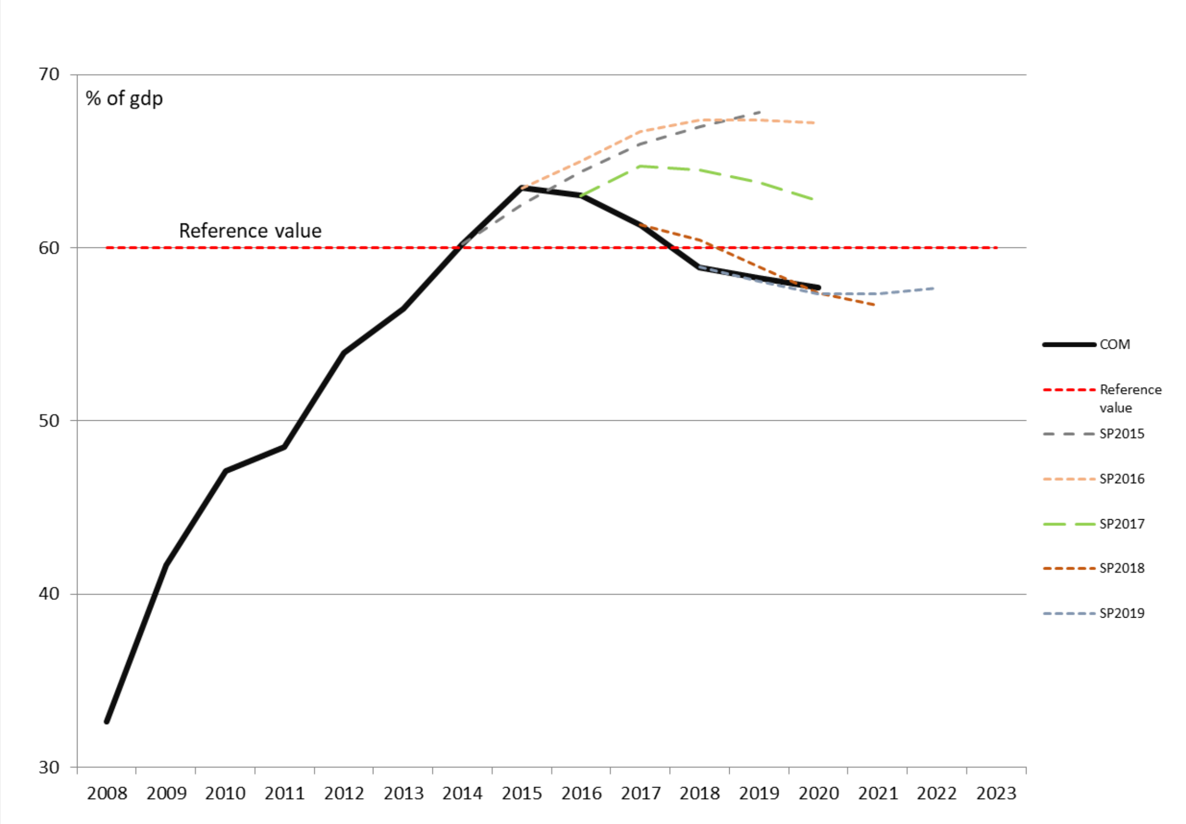
Source:

Commission 2019 spring forecast (COM); Stability Programme (SP), Comission calculations.

In 2018, Finland achieved a primary surplus of 0.2% of GDP while the "snow-ball" effect also contributed significantly to debt reduction thanks to robust growth and low interest rates (1.6% of GDP). In addition, the stock-flow adjustment was negative and helped further lower the debt ratio (0.6% of GDP). Over the Programme horizon, the primary surplus is projected to increase (up to 0.8% of GDP in 2020 and 2021), helping to bring down the debt ratio. Nominal GDP growth is also projected to have a positive, albeit gradually weakening impact on the debt ratio. Interest expenditure is expected to stabilise in coming years at the current level, implying a lower effective average interest rate.

These debt-reducing factors are to a large extent offset by stock-flow adjustment (up to an annual 1.0% of GDP in 2020-2022), which is dominated by the accumulation of financial assets and therefore slows down debt reduction over the Programme period. This adjustment is driven by the statutory earnings-related pension system, which is included in the general government sector and its balance enters the general government balance. Finland's earnings-related pension system is partly funded as some of the financing of pensions comes from prefunded pension assets and the income from them. In the current period, pension funds have been permanently in surplus. This surplus, however, is not used to pay off the public debt but is accounted as net accumulation of financial assets under stock-flow adjustment.

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



Source: Commission 2019 Spring Forecast. Stability programmes

3.5. RISK ASSESSMENT

Overall, the Stability Programme's macroeconomic and fiscal projections appear plausible over the Programme horizon. The Commission 2019 spring forecast broadly confirms the deficit and debt projections for 2019 and 2020. Finland has rigorously controlled the growth of expenditure during term of the outgoing government. The projections for 2020 and beyond are subject to the policy decisions of the new government coalition that will take office after the general elections in April 2019.

The Commission forecasts a slightly higher headline deficit in 2019 and 2020 than the Finnish Ministry of Finance. The difference amounts to 0.1% of GDP for 2019 and 0.2% of GDP for 2020 and is driven mainly by a somewhat more pessimistic macroeconomic outlook in the Commission forecast, which expects nominal GDP growth to decrease from 4.3% in 2018 to 3.1% in both 2019 and 2020 as opposed to the 3.5% and 3.3%, respectively, projected by the authorities in the Stability Programme. The lower growth is expected to bring lower revenues and lead to higher expenditure of the government.

The moderation is expected to be primarily due to dwindling foreign demand and a slowdown in the construction sector after a few years of exceptional growth. Private consumption is expected to remain the main driver of growth. One of the key drivers in the recent economic upswing in Finland was investment, in particular in construction. As growing capacity constraints and fewer new housing projects indicate a sectoral slowdown, we expect construction investment to slow down. In addition, due to dwindling foreign demand in 2019, exports are set to remain subdued, in spite of a major ship delivery that was postponed from last year. According to the Commission 2019 spring forecast, a decelerating profile for GDP is likely, as the Finnish economy is expected to revert to its potential growth rate (1.0-1.5%) in the medium term. The slowdown is also explained by an expected gradual adjustment in monetary policy and less dynamic external demand.

Additional risks to the debt projections are linked to the high level of the government's contingent liabilities, largely comprising guarantees, the nominal value of which has increased significantly in recent years. Guarantees issued by Finnvera, a state-owned financing company[2], and central government funds have seen particularly high increases. The growth in Finnvera guarantees has been concentrated in the area of export credit guarantees related to ship exports. In the growth of government guarantees granted through the National Housing Fund, guarantees for mortgage loans for rental and right-of-occupancy housing is prominent. The nominal value of central government guarantees has increased from EUR 23.2 billion in 2010 to EUR 56.6 billion in 2018, which amounts to approximately 24% of GDP. According to Eurostat, Finland's general government guarantees-to-GDP ratio was the highest among the EU Member States in 2017.

In an exceptionally difficult economic situation, the fiscal position may weaken due to a number of different factors simultaneously. Risks relating to macroeconomic developments, public debt, public sector holdings, granted export credit guarantees and other public sector risks are correlated. Costs arising from the triggering of central government liabilities may impose a significant burden on the economy. This highlights the importance of careful assessment and management of the risks associated with binding financial decisions of the general government and the management and monitoring of all (explicit and contingent) liabilities.

[2] Finnvera is the official export credit agency for Finland. It also provides loans, credits and guarantees to support the start, growth and internationalisation of Finnish enterprises.

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

Box 1. Council Recommendations addressed to Finland

On 13 July 2018, the Council addressed recommendations to Finland in the context of the European Semester. In particular, in the area of public finances the Council recommended Finland to achieve the medium-term budgetary objective (-0.5% of GDP) in 2019, taking into account the allowances linked to the implementation of the structural reforms for which a temporary deviation is granted. The Council recalled that based on the Commission 2018 spring forecast Finland should ensure that the nominal growth rate of net primary government expenditure in 2019 does not exceed 2.9%, corresponding to a maximum allowed deterioration in the structural balance by 0.2% of GDP.

4.1. Compliance with the MTO or the required adjustment path towards the MTO

Assessment of requests for deviating from SGP requirements

In 2016, Finland was granted a deviation for unusual events amounting to 0.17% of GDP.

In addition, in 2017, Finland was granted a temporary deviation of 0.5% of GDP from the required adjustment path towards the MTO to take account of major structural reforms with a positive impact on the long-term sustainability of public finances. In particular, Finland was granted a temporary deviation for the 2017 pension reform and the Competitiveness Pact.

The Stability Programme reports on the implementation of the structural reform in 2018. The implementation in 2018 broadly follows the announced plans to carry out a reform of the pension system and implement measures included in the Competitiveness Pact, namely income tax reductions, changes to health insurance contributions, extension of annual working time and cut of public holiday bonuses. The Stability Programme reconfirms a positive effect of the reform measures on economic growth, employment and public finances in the long run, which appears plausible.

A Member State benefiting from flexibility that is at, or close to, its MTO 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. Overall, this implies for Finland allowed total deviations under the unusual events and structural reform clauses amounting to 0.67% of GDP in 2018 and 0.5% of GDP in 2019.

Compliance with the MTO

On the basis of 2018 outturn data and the Commission 2019 spring forecast, in 2018 the structural balance was maintained above the MTO, taking account of the allowances granted under the structural reform clause (0.5% of GDP) and the unusual events clause (0.17% of GDP).

Based on both the Stability Programme and the Commission 2019 spring forecast, Finland is expected to meet its MTO in 2019, taking into account the allowance granted under the structural reform clause. Thus, the current assessment points to compliance in 2019. At the same time, Finland has a requirement that the nominal growth rate of net primary government expenditure should not exceed 2.9% in 2019, corresponding to a maximum deterioration of the structural balance by -0.2%. The expenditure benchmark would currently points to a risk of a significant deviation from the requirement in 2018 and 2019 taken together, based on the

Stability Programme. If compliance with the MTO in 2019, taking into account the allowance granted under the structural reform clause, could no longer be established in future assessments, an overall assessment would need to take into account a possible deviation from the requirement.

Based on the Stability Programme, Finland is expected to overachieve its MTO in 2020. Based on the Commission 2019 spring forecast, Finland is expected to be close to its MTO in 2020 (gap of 0.1% of GDP). Thus, the current assessment points to broad compliance in 2020. At the same time, Finland has a requirement that the nominal growth rate of net primary government expenditure should not exceed 1.9% in 2020, corresponding to an improvement of the structural balance by 0.5% in 2020. The expenditure benchmark would currently point to a risk of some deviation from the requirement in 2020.

Regarding the expenditure benchmark for 2019 and 2020, the average two-year deviation according to the Stability Programme is estimated at -0.3% for both years, while the average two-year deviation based on the Commission forecast is -0.2%, which implies some deviation from the required adjustment. The difference stems from slightly different estimates for the impact of discretionary revenue measures. Regarding the change in the structural balance in 2020, the assessment according to the Stability Programme points to compliance, while the assessment according to the Commission forecast indicates a one-year deviation of -0.1% from the required adjustment. The difference is not significant and results from a more conservative projection of structural balance in the Commission forecast.

Table 4: Compliance with the requirements under the preventive arm

(% of GDP)	2018	2019		2020	
Background budgetary indicators[1]					
Medium-term budgetary objective (MTO)	-0.5	-0.5		-0.5	
Structural balance[2] (COM)	-1.0	-1.0		-0.6	
Setting the required adjustment to the MTO					
Structural balance based on freezing (COM)	-0.8	-1.0		-	
Position vis-à-vis the MTO[3]	At or above the MTO	Not at MTO		Not at MTO	
Required adjustment[4]	0.0	0.3		0.5	
Required adjustment corrected[5]	-0.5	-0.2		0.5	
Corresponding expenditure benchmark[6]	2.6	2.9		1.9	
Compliance with the required adjustment to the MTO					
	COM	**SP**	**COM**	**SP**	**COM**
Structural balance pillar					
Change in structural balance[7]	-0.3	0.1	0.0	0.5	0.4
One-year deviation from the required adjustment[8]	0.2	0.3	0.2	0.0	-0.1
Two-year average deviation from the required adjustment[8]	0.8	0.2	0.2	0.1	0.0
Expenditure benchmark pillar					
Net public expenditure annual growth corrected for one-offs[9]	3.1	3.6	3.3	2.3	2.3
One-year deviation adjusted for one-offs[10]	-0.2	-0.3	-0.2	-0.2	-0.2
Two-year deviation adjusted for one-offs[10]	0.4	-0.3	-0.2	-0.3	-0.2
Finding of the overall assessment	**Compliance**	**Compliance**	**Compliance**	**Compliance**	**Some deviation**

Legend

'*Compliance*' - the recommended structural adjustment or a higher adjustment is being observed.

'*Some deviation*' - a deviation from the recommended structural adjustment is being observed, but it is below the threshold for a significant deviation.

'*Significant deviation*' - a deviation which has reached or breached the threshold for a significant deviation (i.e. 0.5% of GDP over one year, 0.25% of GDP over two years on average).

Irrelevant for the Significant Deviation Procedure' - a SDP would not be opened only based on the two-year deviation if the MTO has reached (at the time of the freezing or on the base of the last storage) in one of the two years.

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 point is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = 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, 2018 edition, p.38.). In case of a SDP, the requirement corresponds to the Council recommendation when available; otherwise it refers to the Commission recommendation to the Council.

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

[6] 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.

[7] Change in the structural balance compared to year t-1. Expost assessment (for 20XX-1) is carried out on the basis of Commission 20XX spring forecast.

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

[9] Net public expenditure annual growth (in %) corrected for discretionary revenue measures, revenue measures mandated by law and one-offs (nominal)

[10] 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 :
Stability Programme (SP); Commission 2019 spring forecast (COM); Commission calculations.

5. DEBT SUSTAINABILITY ANALYSIS AND FISCAL RISKS

Finland does not appear to face fiscal sustainability risks in the short run.[3]

Based on the Commission 2019 spring forecast and a no-fiscal policy change scenario beyond the forecast horizon, government debt, projected at 58.3% of GDP in 2019, is expected to decrease to 56.1% in 2029, thus remaining below the 60% of GDP Treaty threshold. Over this horizon, government debt is projected to decrease. The sensitivity analysis shows similar risks.[4] Overall, this debt sustainability analysis points to low risks for the country in the medium term. The full implementation of the Stability Programme would put debt on a similar path, slightly more increasing by 2022 and slightly more decreasing thereafter, still always remaining below the 60% of GDP reference value. The government debt would decrease to 55.4% of GDP by 2029.

The medium-term fiscal sustainability risk indicator S1[5] is at 0.0 percentage points of GDP, primarily related to the good initial budgetary position which (contributing -1.2 percentage points of GDP) that together with a small buffer in the level of government debt (contributing -0.2 percentage points of GDP) counterbalance the projected ageing cost (amounting to 1.3 percentage points of GDP). This indicator thus confirms low risks in the medium term. The full implementation of the Stability Programme would put the sustainability risk indicator S1 at -0.3 percentage points of GDP. Based on the debt sustainability analysis and the S1 indicator, overall medium-term fiscal sustainability risks are, therefore, low. Fully implementing the fiscal plans in the Stability Programme would slightly increase those risks, keeping the same overall assessment.

The long-term fiscal sustainability risk indicator S2 is at 2.5 % of GDP. In the long term, Finland therefore appears to face medium fiscal sustainability risks, primarily related to the projected ageing costs contributing 2.0 percentage points of GDP, in particular the long-term care costs (contributing 1.6 percentage points of GDP). Full implementation of the programme would put the S2 indicator at 2.2 percentage points of GDP, leading to a slightly lower long-term risk.[6] The debt sustainability analysis discussed above points to low risks but, overall, long-term fiscal sustainability risks are assessed as medium for Finland.

[3] This conclusion is based on the short-term fiscal sustainability risk indicator S0. See the note to Table 5 for a definition of the indicator.

[4] Sensitivity analysis includes several deterministic debt projections, as well as stochastic projections (see Fiscal Sustainability Report 2018 for more details).

[5] See the note to Table 5 for a definition of the indicator.

[6] The projected costs of ageing that are used to compute the debt projections and the fiscal sustainability indicators S1 and S2 are based on the projections of the 2018 Ageing Report.

Table 5: Debt sustainability analysis and sustainability indicators

Time horizon				Commission Scenario		Stability / Convergence Programme Scenario	
Short-term				**LOW risk**			
S0 indicator [1]				0.1			
	Fiscal subindex			0.1	LOW risk		
	Financial & competitiveness subindex			0.2	LOW risk		
Medium-term				**LOW risk**			
DSA [2]				LOW risk			
S1 indicator [3]				0.0	LOW risk	-0.3	LOW risk
of which	Initial Budgetary Position			-1.2		-1.1	
	Debt Requirement			-0.2		-0.2	
	Cost of Ageing			1.3		1.1	
		of which	Pensions	0.6		0.4	
			Health care	0.2		0.1	
			Long-term care	0.5		0.4	
			Other	0.1		0.1	
Long-term				**MEDIUM risk**			
DSA [2]				LOW risk			
S2 indicator [4]				2.5	MEDIUM risk	2.2	MEDIUM risk
of which	Initial Budgetary Position			0.5		0.6	
	Cost of Ageing			2.0		1.6	
		of which	Pensions	0.1		-0.1	
			Health care	0.5		0.5	
			Long-term care	1.6		1.5	
			Other	-0.2		-0.2	

Source: Commission services; 2019 stability/convergence programme.

Note: the 'Commission' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2019 forecast until 2020. The 'stability/convergence programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period covered by the programme. Age-related expenditure as given in the 2018 Ageing Report.

[1] The S0 indicator of short term fiscal challenges informs the early detection of fiscal stress associated to fiscal risks within a one-year horizon. To estimate these risks S0 uses a set of fiscal, financial and competitiveness indicators selected and weighted according to their signalling power. S0 is therefore a composite indicator whose methodology is fundamentally different from the S1 and S2 indicators, which quantify fiscal adjustment efforts. The critical threshold for the overall S0 indicator is 0.46. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.36 and 0.49*.

[2] Debt Sustainability Analysis (DSA) is performed around the no fiscal policy change scenario in a manner that tests the response of this scenario to different shocks presented as sensitivity tests and stochastic projections*.

[3] The S1 indicator is a medium-term sustainability gap; it measures the upfront fiscal adjustment effort required to bring the debt-to-GDP ratio to 60 % by 2033. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2021 for Commission scenario and from last available year for the SCP scenario); it must be then sustained, including financing for any additional expenditure until the target date, arising from an ageing population. The critical thresholds for S1 are 0 and 2.5, between which S1 indicates medium risk. If S1 is below 0 or above 2.5, it indicates low or high risk, respectively*.

[4] The S2 indicator is a long-term sustainability gap; it shows the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon, including the costs of ageing. The critical thresholds for S2 are 2 and 6, between which S2 indicates medium risk. If S2 is below 2 or above 6, it indicates low or high risk, respectively*.

* For more information see Fiscal Sustainability Report 2018.

6. FISCAL FRAMEWORK

The National Audit Office of Finland monitors and evaluates fiscal policy in its role as a national independent fiscal institution under the EU Fiscal Compact and within the meaning of EU law. Provisions on the evaluation task are laid down in the Act on the National Audit Office of Finland (676/2000) and the "Fiscal Policy Act"[7] (869/2012). The evaluation comprises the assessment of the setting and implementation of the fiscal policy rules and the steering of government finances. It covers monitoring of the compliance with the medium-term budgetary objective (MTO) and the related correction mechanism, monitoring of the preparation and implementation of the General Government Fiscal Plan and monitoring of compliance with the Stability and Growth Pact. It also covers the assessment of whether the macroeconomic forecasts used in fiscal policy-making are realistic as well as the ex-post assessment of the reliability of the macroeconomic and fiscal forecasts as laid down in the Government Decree on the General Government Fiscal Plan (120/2014, as amended by decree 601/2017).

On 4 December 2018, Finland's National Audit Office published a Fiscal Policy Monitoring and Audit Report on the 2015-2018 Parliamentary Term. According to this report, most of the objectives regarding the general government fiscal position and debt set by the Government at the beginning of the parliamentary term were to be reached. This was supported especially by the economic growth that started in 2016. The long-term sustainability gap of general government finances was not eradicated during the parliamentary term, but it became smaller.

According to the National Audit Office's assessment, during the parliamentary term the Government complied with the Fiscal Policy Act and the related regulations in all essential respects, following the spending limits. Fiscal planning and governance in general improved during the parliamentary term and related legislation was developed. On the other hand, the governance does not take into account risks related to the contingent liabilities of central government entities, such as increased government guarantees. The National Audit Office recommended implementation of a risk-based limit for the contingent liabilities.

In its programme, the government has committed to achieving the MTO by 2019. According to the Stability Programme, as discussed in conjunction of the medium-term strategy (section 3.2), Finland still plans to achieve this target. The recalculated structural balance points to the feasibility of this plan. Therefore, based on the information provided in the Stability Programme, the past, planned and forecast fiscal performance in Finland appears to comply with the requirements of the applicable national numerical fiscal rules.

Finland's Stability Programme is an annex to the General Government Fiscal Plan for 2020-2023, which serves as Finland's national medium-term fiscal plan in accordance with the Two-Pack Regulation 473/2013. This is clearly stated in the introduction of the plan. The Regulation requires the Member States to present indications on the expected economic returns on significant non-defence public investment with significant fiscal impact. Neither the General Government Fiscal Plan 2020-2023 nor the National Reform Programme 2019 provide such information for the years concerned.

The macroeconomic forecasts underpinning the Stability Programme and national medium-term fiscal plan in the meaning of the Regulation 473/2013 are produced by an independent

[7] Act on the Implementation and Application of the Provisions Governed by the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union and on Requirements Concerning Multiannual Budgetary Frameworks

forecaster, the Economics department of the Ministry of Finance. Finland is the only euro-area country where the independent macroeconomic forecast is prepared by the Ministry of Finance, which is also responsible for the preparations of the central government annual budgets and the steering of general government finances. 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.

7. SUMMARY

In 2018, Finland overachieved its MTO taking account of the allowance granted under the flexibility clauses.

Finland is expected to remain at its adjusted MTO in 2019 and close to the MTO in 2020. At the same time, based on the Stability Programme, the expenditure benchmark would currently point to a risk of a significant deviation from the requirement in 2018 and 2019 taken together as well as in 2019 and 2020 taken together. If compliance with the MTO, taking into account the allowance linked to implementation of structural reforms, can no longer be established in future assessments, an overall assessment would need to take into account a possible deviation from the requirement.

Based on the Stability Programme, with gross public debt below 60% of GDP, Finland is compliant with the debt criterion. This is confirmed by the Commission 2019 spring forecast.

8. ANNEXES

Table I. Macroeconomic indicators

	2001-2005	2006-2010	2011-2015	2016	2017	2018	2019	2020
Core indicators								
GDP growth rate	2.6	0.9	0.1	2.8	2.7	2.3	1.6	1.2
Output gap [1]	-0.3	0.3	-2.3	-1.7	-0.3	0.7	0.9	0.8
HICP (annual % change)	1.4	2.0	2.0	0.4	0.8	1.2	1.4	1.6
Domestic demand (annual % change) [2]	2.8	0.9	0.6	3.2	1.8	2.3	1.3	1.1
Unemployment rate (% of labour force) [3]	8.9	7.5	8.4	8.8	8.6	7.4	6.7	6.2
Gross fixed capital formation (% of GDP)	22.3	23.2	21.3	21.7	22.1	22.5	22.7	22.8
Gross national saving (% of GDP)	29.1	26.4	20.4	21.3	22.1	22.5	22.8	23.0
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	3.3	1.6	-2.4	-1.7	-0.8	-0.7	-0.4	-0.2
Gross debt	41.3	38.7	56.5	63.0	61.3	58.9	58.3	57.7
Net financial assets	39.6	61.5	51.4	53.3	58.7	52.4	n.a	n.a
Total revenue	52.0	52.2	54.3	54.2	53.4	52.5	52.5	52.4
Total expenditure	48.8	50.6	56.6	55.9	54.2	53.1	52.8	52.6
of which: Interest	1.9	1.4	1.3	1.1	1.0	0.9	0.9	0.9
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	4.5	3.7	3.0	4.2	4.0	2.6	0.9	0.2
Net financial assets; non-financial corporations	-137.3	-128.9	-112.1	-128.0	-130.4	-128.4	n.a	n.a
Net financial assets; financial corporations	2.7	1.4	4.0	4.3	2.3	-0.4	n.a	n.a
Gross capital formation	13.0	13.1	11.4	11.5	11.8	12.4	12.0	11.7
Gross operating surplus	27.4	25.8	22.2	22.8	24.5	24.8	24.4	24.4
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	-1.5	-2.3	-2.0	-3.2	-3.6	-3.1	-1.2	-0.7
Net financial assets	63.4	58.2	63.2	71.0	71.4	66.4	n.a	n.a
Gross wages and salaries	37.6	38.9	40.2	39.1	38.5	38.6	39.0	39.2
Net property income	4.3	3.9	3.9	4.1	4.0	4.2	6.1	7.2
Current transfers received	19.5	19.6	22.7	23.3	22.8	22.1	21.9	21.7
Gross saving	4.8	4.6	4.6	3.6	3.4	4.2	6.4	7.3
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	6.1	2.9	-1.4	-0.8	-0.2	-1.8	-1.4	-1.3
Net financial assets	31.5	7.8	-6.6	-0.6	-1.9	9.9	n.a	n.a
Net exports of goods and services	6.9	3.2	-0.9	-1.0	0.3	-0.6	-0.4	-0.4
Net primary income from the rest of the world	0.2	0.8	0.6	1.4	0.3	-0.3	-0.2	-0.2
Net capital transactions	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Tradable sector	47.0	43.5	39.2	38.4	39.1	39.3	n.a	n.a
Non tradable sector	40.6	44.1	47.0	47.7	47.3	47.0	n.a	n.a
of which: Building and construction sector	5.2	5.9	5.5	5.9	6.2	6.3	n.a	n.a
Real effective exchange rate (index, 2000=100)	93.5	99.1	102.9	100.6	98.0	99.5	99.0	99.1
Terms of trade goods and services (index, 2000=100)	111.2	101.7	99.1	102.7	102.5	103.0	102.4	102.3
Market performance of exports (index, 2000=100)	107.3	106.7	92.2	84.8	87.3	86.0	86.5	86.6

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2015 market prices.

[2] The indicator on domestic demand includes stocks.

[3] Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.

Source :
AMECO data, Commission 2019 spring forecast

Mandatory variables that were not included in the Stability Programme

The Stability Programme does not include several mandatory variables for the following categories:

- Price developments: 2018 levels;
- Divergence from previous update: estimates for 2022 from the previous update;
- Contingent liabilities: data on public guarantees in 2019;
- Basic assumptions: all variables for 2022 and for 2021 nominal effective exchange rate, EU GDP growth and world excluding EU GDP growth.

The mandatory variables that were not included do not impede the Commission's ability to assess the Stability Programme on the basis of the Programme's assumptions.