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COMMISSION OPINION

of 20.11.2019

on the Draft Budgetary Plan of Finland

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING FINLAND

3. On 7 October 2019, Finland submitted the Draft Budgetary Plan for 2020. On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013. By letter of 14 October 2019, the Commission asked Finland for further information. It has taken the reply by Finland of 16 October 2019 into account in its assessment of budgetary developments and risks. Finland also submitted an updated Stability Programme on 7 October 2019.

4. Finland is subject to the preventive arm of the Stability and Growth Pact. On 9 July 2019, 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 towards the medium-term budgetary objective of -0.5% of GDP.[1]

5. According to the Commission 2019 autumn forecast, the Finnish economy is expected to grow by 1.4% in 2019 and 1.1% in 2020. The Draft Budgetary Plan expects marginally higher growth in 2019 (1.5%) and marginally lower growth in 2020 (1.0%). The composition of growth is different with somewhat higher growth of private consumption and lower growth of investment in the Draft Budgetary Plan compared to the Commission forecast. Overall, the macroeconomic scenario underlying the Draft Budgetary Plan is plausible for 2019 and 2020. Finland complies with the requirement of Regulation EU No 473/2013 since the draft budget is based on independently produced macroeconomic forecasts.

6. The Draft Budgetary Plan projects a general government headline deficit of 1.0% of GDP in 2019, increasing to 1.4% of GDP in 2020. The Commission expects the headline deficit at 1.1% in 2019 and 1.4% in 2020. The difference for 2019 is explained mainly by the higher Commission estimation of government expenditure.

[1] 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.

In the Draft Budgetary Plan, the recalculated structural balance[2] is estimated to reach a deficit of 1.4% of GDP in 2019 and of 1.5% of GDP in 2020. These projections are similar to the Commission 2019 autumn forecast, which expects a structural deficit of 1.4% in 2019 and 1.6% in 2020. The deterioration of the fiscal position in 2020 is partly explained by the discretionary fiscal measures adopted by the government, which entail scaling up spending that is planned to be only partially covered by additional tax revenue. According to the Finnish authorities, these fiscal plans aim at increasing employment and long-run productivity and they are to be implemented in the context of the projected continued economic slow down.

7. From 2020 onwards, the government has decided to pursue an expansionary fiscal stance, fostering structural reforms. This is confirmed by the Commission 2019 autumn forecast. The government's plans foresee a permanent increase in annual expenditure by EUR 1.1 billion (0.5% of GDP) in 2020, increasing further 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 so-called 'future-oriented investment' during its term (2020-2023), out of which EUR 0.7 billion (0.3% of GDP) is already appropriated for 2020. Overall, the expenditure increase planned for 2020 amounts to EUR 1.9 billion (0.8% of GDP) and falls into various categories, with the largest increase in social benefits (0.2% of GDP), gross fixed capital formation (0.2% of GDP) and intermediate consumption (0.2% of GDP).

The government plans to finance what it considers permanent annual expenditure increase through back-loaded tax increases, mainly excise taxes, which are expected to increase government revenues by EUR 0.2 billion (0.1% GDP) in 2020, on top of revenue measures decided by the previous government, amounting to 0.1% of GDP. The government expects that, by 2023, the revenue from higher excise taxes will reach EUR 0.7 billion (0.3% of GDP) while revenue from increasing employment will cover a part of the remaining budgetary gap. The 'future-oriented investments', which are planned to be phased out by 2023, are to be financed by sales of State assets. The expenditure-revenue mismatch is expected to lead to a deterioration of the general government headline deficit in 2020 by 0.5% of GDP. However, it is not expected to lead to a proportional increase of the government debt, since part of the expenditure is planned to be covered by asset sales.

The government has decided to continue the gradual tax shift away from taxation of earned income favouring low and middle-income earners (lowering personal income taxes for those groups) towards indirect taxes on items such as energy, traffic fuels, tobacco, alcohol and soft drinks. The tax base is expected to be strengthened by phasing out during the parliamentary term the right to deduct interest on home loans. The domestic work credit is also planned to be reduced. The temporary solidarity tax for high-income brackets is expected to become permanent.

The tax wedge on labour in Finland is close to the EU average. The Draft Budgetary Plan includes both, measures decreasing (e.g. reduction of income tax for low and middle income earners, lowering of social contributions for unemployment insurance) and increasing the tax burden on labour (raising back social contributions for sickness insurance, maintaining the 'solidarity tax' for high income earners). Overall, the planned measures are slightly increasing the tax wedge on labour.

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

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 were not adopted by the Parliament in due time by March 2019 due to constitutional concerns. The current government pledged to implement the reforms aimed at reducing expenditure growth in healthcare and ensuring equal access to health and social services by the end of the current parliamentary term, but the possible costs savings from the reform have not been estimated yet.

8. In 2019, for Finland to comply with the requirements of the preventive arm, the nominal growth rate of government expenditure, net of discretionary revenue measures and one-offs, should not exceed 2.9%, corresponding to a maximum deterioration of 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 indicators point in the same direction (gap of 0.2% of GDP and 0.4% of GDP based on the structural balance and the expenditure benchmark, respectively). The Commission 2019 autumn forecast confirms the conclusion of a risk of some deviation in 2019.

In 2020, for Finland to comply with the requirements of the preventive arm, the nominal growth rate of government expenditure, net of discretionary revenue measures and one-offs, should not exceed 1.9%, corresponding to an annual structural adjustment by 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 (gap of 0.6% of GDP and 0.8% of GDP based on the structural balance and the expenditure benchmark, respectively). The overall assessment also points to a risk of a significant deviation in 2019-2020 taken together (average gap of 0.4% of GDP and 0.6% of GDP based on the structural balance and the expenditure benchmark, 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.

9. Finland reduced its gross public debt from the peak of 63.0% of GDP in 2016 to 59.0% of GDP in 2018. The Draft Budgetary Plan and the Commission 2019 autumn forecast consistently indicate that government debt will remain below the reference value of the Treaty of 60% of GDP by 2020.

10. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Finland is at risk of non-compliance with the provisions of the Stability and Growth Pact. The public debt ratio is projected to remain below the 60% of GDP Treaty reference value and the headline budget balance provides a sizeable margin from the 3% of GDP Treaty reference value. The Commission invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2020 budget will be compliant with the Stability and Growth Pact.

The Commission is also of the opinion that Finland has made limited progress with regard to the structural part of the fiscal recommendations contained in the Council Recommendation of 9 July 2019 in the context of the European Semester and thus invites the authorities to accelerate progress. A comprehensive description of progress made with the implementation of the country-specific recommendations will be made in the 2020 Country Reports and assessed in the context of the country-specific recommendations to be proposed by the Commission in spring 2020.

Done at Brussels, 20.11.2019

For the Commission
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Member of the Commission