EUROPEAN
COMMISSION

Brussels, 13.5.2015
COM(2015) 246 final

# REPORT FROM THE COMMISSION

## Finland

## Report prepared in accordance with Article 126(3) of the Treaty

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## 1. INTRODUCTION

Article 126 of the Treaty on the Functioning of the European Union (TFEU) lays down the excessive deficit procedure (EDP). This procedure is further specified in Council Regulation (EC) No 1467/97 "on speeding up and clarifying the implementation of the excessive deficit procedure"[1], which is part of the Stability and Growth Pact. Specific provisions for euro area Member States under EDP are laid down in Regulation (EU) No 473/2013[2].

According to Article 126(2) TFEU, the Commission has to monitor compliance with budgetary discipline on the basis of two criteria, namely: (a) whether the ratio of the planned or actual government deficit to gross domestic product (GDP) exceeds the reference value of 3% (unless either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value); and (b), whether the ratio of government debt to GDP exceeds the reference value of 60% (unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace).

Article 126(3) TFEU stipulates that, if a Member State does not fulfil the requirements under one or both of the above criteria, the Commission has to prepare a report. The Commission may also prepare a report if, notwithstanding the fulfilment of the requirements under the criteria, it is of the opinion that there is a risk of an excessive deficit, the latter understood as the situation defined in Article 126(2) TFEU. This report also has to "*take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State*".

This report, which represents the first step in the EDP, analyses the reasons for Finland being non-compliant with the deficit and debt criterion of the Treaty, with due regard to the economic background and other relevant factors.

Following the amendments to the Stability and Growth Pact in 2011, the debt requirement has been put on an equal footing with the deficit requirement in order to ensure that, for countries with a debt-to-GDP ratio above the 60% reference value, the ratio is brought below (or sufficiently declining towards) that value.

The report updates the previous Commission's assessment of the excess of the debt ratio over the reference value of 27 February 2015[3]. In the February report it was found that Finland is in compliance with the debt criterion on account of the contribution to the solidarity operations. Respect of the deficit criterion was not considered in detail, as the previous forecasts indicated that the deficit would remain below the 3%-of-GDP reference value. The

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1 OJ L 209, 2.8.1997, p. 6. The report also takes into account the "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 3 September 2012, available at: http://ec.europa.eu/economy_finance/economic_governance/sgp/legal_texts/index_en.htm.

2 OJ L 140, 27.5.2013, p. 11: Regulation (EU) No 473/2013 of the European Parliament and of the Council on "common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area".

3 COM(2015) 114 final - http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/30_edps/126-03_commission/2015-02-27_fi_126-3_en.pdf

current report takes account of the Commission's 2015 spring forecast and an evaluation of subsequent developments, in order to examine whether further steps under the EDP are warranted, after all relevant factors have been considered, where appropriate. Section 2 of the report examines compliance with the deficit criterion. Section 3 examines compliance with the debt criterion. Section 4 deals with public investment and other relevant factors.

Data notified by the authorities on 30 March 2015 and subsequently validated by Eurostat show that the general government deficit in Finland reached 3.2% of GDP in 2014, thus exceeding the 3%-of-GDP reference value, while the debt was at 59.3% of GDP, below the 60%-of-GDP reference value. In its Stability Programme, submitted on 2 April 2015, Finland plans the deficit to increase further to 3.4% of GDP in 2015 and to bring it below the 3%-of-GDP reference value of the Treaty only in 2018. These projections are based on a no-policy-change assumption applied pending the formation of a new government after the national elections held on 19 April. Similarly, according to the Commission's 2015 spring forecast, the deficit is forecast to stay above 3% in 2015 and 2016.

Both the Stability Programme and the Commission's spring forecast indicate that the gross debt ratio would be above the 60% reference value of the Treaty by the end of 2015 and in 2016. Thereafter, the Stability Programme projects the gross debt ratio to remain above 60% over the programme horizon.

The notified deficit for 2014 and the planned deficit and debt ratios for 2015 provide *prima facie* evidence on the existence of an excessive deficit based on both the deficit and debt criterion in Finland in the sense of the Stability and Growth Pact before however considering all relevant factors, where appropriate, as set out below.

## 2. DEFICIT CRITERION

According to Finland's notification of 30 March 2015, validated by Eurostat on 21 April 2015, its general government deficit amounted to 3.2% of GDP in 2014, against 2.5% of GDP in 2013. The deficit was larger than expected in the Commission's 2015 winter forecast (2.7% of GDP), due to negative surprises affecting both revenue and expenditure developments. In particular, revenue from indirect taxes proved weaker than expected, as was government property income. Expenditure on intermediate consumption also turned out to be higher than planned.

In 2015, the deficit is projected to increase to 3.4% of GDP in the Stability Programme and, based on a no-policy-change assumption; it would decline to 3.2% of GDP in 2016. The increase in the deficit is mainly due to a foreseen stronger increase in the expenditure-to-GDP ratio. Increases in expenditure are concentrated in the social transfers. Interest expenditure is decreasing, but this is more than offset by a decline in revenue from government assets.

There are no indications, at this stage, that measures affecting the budgetary outcome of 2015 will be taken by the incoming government, but pending the publication of the actual programme, this possibility can also not be excluded. According to the Finnish authorities, a supplementary budget for 2015 would be finalized in the autumn. Such a supplementary budget late in the year could be expected to have only a limited impact on the 2015 outcome.

The Stability Programme, which has been submitted on a no-policy-change basis, does not project the general government deficit to fall below 3% of GDP until 2018. The new government is expected to adopt a new general government fiscal plan for 2016-2019 together with the 2016 central government budget proposal in early autumn.

Although in excess of 3% of GDP, the deficit is close to the Treaty reference value in 2014 and is forecast to remain so in 2015 and 2016.

The excess over the 3% of GDP reference value in 2014 can be considered exceptional, as the 2014 deficit was negatively affected by the changeover to the ESA2010 methodology, and in particular the change in the treatment of swaps. The specific "EDP deficit" concept which existed under ESA 95 has been discontinued with the transition to ESA 2010. The “EDP deficit” defined under ESA 95 included the net impact of interest flows on swaps and forward rate agreements. Since the introduction of ESA 2010 in 2014, this special treatment for swaps under EDP statistics has disappeared and these are treated as financial transactions directed at derivatives and not as interest. As a result, the 2013 deficit was revised upwards by 0.3% of GDP. This was partly compensated by the increase in nominal GDP resulting from the implementation of ESA 2010, which led to a decline in the deficit-to-GDP ratio by 0.1pp of GDP[4]. Finland continues to use the swap agreements and in 2014, the income from those was 0.3% of GDP. According to the previously-used concept, the deficit would have remained under the 3% of GDP reference value in 2014. Thereafter, for 2015-2016, the effect of the changeover to ESA2010 on the recording of swaps cannot be considered exceptional, as it was fully known and could be incorporated in the budget preparation process.

The excess over the 3%-of-GDP reference value is not temporary in the sense of the Treaty and the Stability and Growth Pact. In particular, the budgetary forecasts as provided by the Commission and the Stability Programme indicate that the deficit will not fall below the reference value before 2017.

In sum, the deficit in 2014, 2015 and 2016 remains close to, but above the 3%-of-GDP reference value. The existing and planned excess over the reference value is not temporary in the sense of the Treaty and the Stability and Growth Pact. The deficit cannot be considered exceptional for the whole period 2014 to 2016. The overall analysis above thus suggests that, before consideration is given to all relevant factors as set out below, *prima facie* the deficit criterion in the sense of the Treaty and Council Regulation (EC) No 1467/97 appears not to be fulfilled based on the 2015 Stability Programme as well as the Commission's 2015 spring forecast.

## 3. DEBT CRITERION

The general government gross debt-to-GDP ratio has increased rapidly over the recent years, growing from 32.7% of GDP in 2008 to 59.3% in 2014, on the back of deficits (as revenue shrank during the severe economic downturn and expenditure remained elevated) and stock-flow adjustments. The deficit and the stock-flow adjustment contributed roughly equally to the growth of nominal debt over these years.

Finland's 2015 Stability Programme plans the debt to increase to 62.5% of GDP in 2015 and to continue increasing throughout the programme horizon to 67.8% of GDP in 2019. According to the Commission's spring 2015 forecast, the debt-to-GDP ratio is expected to exceed the 60% reference value, reaching 62.6% in 2015 and 64.8% in 2016 (Table 1).

When corrected for the effects of the cycle, Finland's general government debt would be below 60% in 2015, but above the reference value in 2016. Similarly, while the solidarity

4 In addition to EDP-related changes, the deficit in 2013 was also revised due to other factors at the time when ESA2010 was implemented. This resulted in an 0.1pp increase in deficit-to-GDP ratio.

operations amounting to 2.9 % of GDP explain the excess of the debt over the reference value in 2015, this would no longer be fully the case in 2016.

The overall analysis above thus suggests that, before consideration is given to all relevant factors as set out below, *prima facie* the debt criterion in the sense of the Treaty and Council Regulation (EC) No 1467/97 appears not to be fulfilled based on the 2015 Stability Programme as well as the Commission's 2015 spring forecast.

**Table 1: Debt dynamics**

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|---|
| Government gross debt ratio | 48.5 | 52.9 | 55.8 | 59.3 | 62.6 | 64.8 |
| Change in debt ratio [b] (1 = 2+3+4) | 1.4 | 4.5 | 2.9 | 3.5 | 3.3 | 2.2 |
| *Contributions:* | | | | | | |
| • Primary balance (2) | -0.4 | 0.7 | -1.3 | -1.9 | -2.1 | -2.1 |
| • "Snowball" effect (3) | -0.9 | 0.9 | 0.7 | 0.7 | 0.3 | -0.3 |
| *of which:* | | | | | | |
| *Interest expenditure* | 1.4 | 1.4 | 1.3 | 1.3 | 1.2 | 1.2 |
| *Real GDP growth* | *-1.2* | *0.7* | *0.6* | *0.1* | *-0.2* | *-0.6* |
| *Inflation (GDP deflator)* | -1.2 | -1.3 | -1.2 | -0.6 | -0.7 | -0.9 |
| • Stock-flow adjustment (4) | 2.7 | 2.9 | 1.1 | 0.9 | 0.9 | 0.5 |

Notes:

[a] In percent of GDP.

[b] The change in the gross debt ratio can be decomposed as follows:

$$\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \left( \frac{D_{t-1}}{Y_{t-1}} * \frac{i_t - y_t}{1 + y_t} \right) + \frac{SF_t}{Y_t}$$

where $t$ is a time subscript; $D$, $PD$, $Y$ and $SF$ are the stock of government debt, the primary deficit, nominal GDP and the stock-flow adjustment respectively, and $i$ and $y$ represent the average cost of debt and nominal GDP growth. The term in parentheses represents the "snow-ball" effect, measuring the combined effect of interest expenditure and economic growth on the debt ratio.

*Source: Eurostat and Commission 2015 spring forecast*

## 4. RELEVANT FACTORS

Article 126(3) of the TFEU stipulates that the Commission's report "*shall also take into account whether the government deficit exceeds government investment expenditure and take into account other relevant factors, including the medium-term economic and budgetary position of the Member State in order to decide whether the breach of the criterion merits the launch of an EDP for the Member State in question*". These factors are further clarified in Article 2(3) of Council Regulation (EC) No 1467/97, which also specifies that "*any other factors which, in the opinion of the Member State concerned, are relevant in order to comprehensively assess in qualitative terms the excess over the reference value and which the Member State has put forward to the Council and the Commission*" need to be given due consideration.

The following subsections consider in turn: (1) the medium-term economic position; (2) the medium-term budgetary position (including public investment); (3) the developments in the medium-term government debt position, its dynamics and sustainability; (4) other factors put forward by the Member State; and (5) other factors considered relevant by the Commission.

The report will reflect the factors mentioned above based on the notified data and the Commission's 2015 spring forecast.

### 4.1. Medium-term economic position

**Cyclical conditions and potential growth.** After Finland's real GDP collapsed by 8.3% in 2009, the country recovered gradually in 2010 and 2011, but experienced a new recession over 2012-2014. In 2014, GDP contracted marginally, by 0.1%. The growth outlook is slowly improving for 2015 and 2016 (table 2). The crisis has negatively affected Finland's potential growth. The growth rate of potential output in Finland, as estimated by the Commission services according to the commonly-agreed method has averaged 0% over the last four years, being negative (at -0.1%) over 2013 and 2014. The contraction of potential output is caused by declining contributions of labour inputs and the estimated negative contribution of total factor productivity, which reflects the ongoing restructuring of the economy. Moreover, the positive contribution of capital also declined over the crisis period, due to low investment. Overall, real GDP in 2014 was 5.5% below the level recorded in 2008, whereas potential output has grown by just 0.6% over this period. The decline in potential growth has a negative impact on debt sustainability.

As real GDP declined over 2012-2014 period, the output gap widened to -2.9% of potential GDP in 2014 and it is expected to slightly improve in 2015 to -2.7% as GDP is estimated to grow above potential (0.1%). In 2016, growth is also forecast to exceed potential growth, reducing the output gap to -1.9% of potential GDP.

**Table 2: Macroeconomic and budgetary developments [a]**

| | 2011 | 2012 | 2013 | 2014 | 2015 | | 2016 | |
|---|---|---|---|---|---|---|---|---|
| | COM | COM | COM | COM | COM | National authorities | COM | National authorities |
| Real GDP (% change) | 2.6 | -1.4 | -1.3 | -0.1 | 0.3 | 0.5 | 1.2 | 1.4 |
| Potential GDP (% change) | 0.2 | 0.0 | -0.1 | -0.1 | 0.2 | 0.2 | 0.1 | 0.2 |
| Output gap (% of potential GDP) | -0.2 | -1.7 | -2.9 | -2.9 | -2.9 | -2.8 | -1.9 | -1.6 |
| General government balance | -1.0 | -2.1 | -2.5 | -3.2 | -3.3 | -3.4 | -3.2 | -3.2 |
| Primary balance | 0.4 | -0.7 | -1.3 | -1.9 | -2.1 | -2.2 | -2.1 | -2.0 |
| One-off and other temporary measures | -0.1 | -0.1 | -0.1 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| Government gross fixed capital formation | 3.8 | 4.0 | 4.2 | 4.1 | 4.1 | 4.3 | 4.1 | 4.3 |
| Cyclically-adjusted balance | -0.9 | -1.2 | -0.9 | -1.5 | -1.7 | -1.8 | -2.1 | -2.3 |
| Cyclically-adjusted primary balance | 0.5 | 0.3 | 0.4 | -0.2 | -0.5 | -0.6 | -1.0 | -1.1 |
| Structural balance [b] | -0.8 | -1.1 | -0.8 | -1.5 | -1.7 | -1.8 | -2.1 | -2.3 |
| Structural primary balance | 0.6 | 0.3 | 0.5 | -0.3 | -0.5 | -0.6 | -1.0 | -1.1 |

Notes:

[a] In percent of GDP unless specified otherwise.

[b] Cyclically-adjusted balance excluding one-off and other temporary measures.

*Source: Eurostat and European Commission 2015 spring forecast, 2015 Stability Programme*

These negative cyclical developments have had a significant impact on the deficit and the debt-to-GDP ratio, but looking forward, the economy is expected to grow above its potential growth rate. If corrected for the cycle over the last three years, the debt ratio in 2015 would remain below the Treaty reference value both according to the Commission and the national authorities, but this would no longer be the case in 2016. Based on the Commission's spring forecast, cyclically-adjusted debt would be 57.1% of GDP in 2015 and 61.3% in 2016 (table 3).

**Table 3. General government deficit and debt (% of GDP)**

| | | 2011 | 2012 | 2013 | 2014 | 2015 | | 2016 | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | COM | COM | National authorities | COM | National authorities |
| Deficit criterion | General government balance | -1.0 | -2.1 | -2.5 | -3.2 | -3.3 | -3.4 | -3.2 | -3.2 |
| Debt criterion | General government gross debt | 48.5 | 52.9 | 55.8 | 59.3 | 62.6 | 55.2 | 64.8 | 64.4 |
| | General government gross debt adjusted for the effect of the cycle | | | | | 57.1 | 56.9 | 61.3 | |

Sources: Eurostat, European Commission 2015 spring forecast, 2015 Stability Programme, data communicated by the national authorities

**Recent structural reforms.** In 2013, Finland adopted a broad structural policy programme for improving growth conditions and reducing the sustainability gap[5]. The government foresaw measures to balance local government finances, increase the efficiency of the public sector, extend working careers by two years and improve competition and competitiveness.

The most important step arising from the structural policy programme is an agreement on a pension reform by the social partners that was concluded in late September 2014. The reform links the retirement age to life expectancy as recommended by the Council in July 2014. Following the expected adoption of the legal acts by the Parliament in 2015, the objective is to implement the reform from 2017 onwards. According to the national authorities, the reform will improve fiscal sustainability by approximately 1% of GDP, but the budgetary effect would not be apparent before 2017. A decision regarding the extended unemployment benefits for workers close to the retirement age ("the unemployment tunnel") has not been taken.

On the other hand, there appears to be only slow progress in limiting the local governments' duties and obligations, an action foreseen to enable the balancing of local governments' budgets. Reforms affecting the social and healthcare system are postponed and require additional preparation. Measures aimed at reducing structural unemployment and at extending careers by inciting young people to start working earlier have, so far, not produced clear results.

The incoming government's targets and intentions regarding the structural reforms remain to be clarified.

## 4.2. Medium-term budgetary position

### Structural deficit and fiscal consolidation

Finland's headline deficit is above 3% of GDP in 2014 and forecast and planned (assuming no changes in policy) by the outgoing government in its Stability Programme to remain above 3% until 2017. According to the applicable Commission forecasts, Finland reached its MTO (a 0.5% of GDP structural deficit) in 2013. Finland has chosen the MTO that is at the least demanding level, reducing the MTO from the previous objective of a 0.5% of GDP structural surplus in 2013.

The ratio of general government expenditure to GDP has increased considerably in recent years. While the average over the period 2006-2010 amounted to 50.6%, the ratio reached 58.7% in 2014 and is projected to remain broadly at the same level in 2015 and 2016 according to the Commission's 2015 spring forecast. In 2014, the expenditure ratio was the highest in the EU.

As Finland started the year 2014 at its MTO and the economy was in recession, no adjustment towards the MTO was required in 2014. However, Finland appears to have actually moved away from the MTO by 0.8% of GDP, which represents a significant deviation under the structural-balance pillar. In contrast, the expenditure benchmark is met with a positive margin of 0.3% of GDP. Overall, part of the deterioration in the structural

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[5] A structural policy programme to strengthen conditions for economic growth and bridge the sustainability gap in general government finances is available at: http://valtioneuvosto.fi/etusivu/rakenneuudistus395285/tiedostot/rakennepoliittinen-ohjelma-29082013/fi.pdf

balance (amounting to ¼ % of GDP[6]), can be attributed to slower-than-expected inflation and therefore the adjustment towards the MTO appears not to have deviated significantly from the requirements in 2014. As inflation turned out to be lower than planned during the preparation of the budget, revenues turned out lower than budgeted which is reflected in the worsening of the structural balance.

The required structural-balance adjustment for 2015 amounts to 0.1% of GDP. Based on the Commission's 2015 spring forecast, the structural balance would worsen instead by 0.2% of GDP in 2015. When calculating the average change in the structural balance over 2014-2015, Finland would exceed the limit of a 0.25% (significant) deviation. On the other hand, the positive margin in the expenditure benchmark increases in 2015 to 0.5% of GDP. Overall, there is a risk of significant deviation from the adjustment path towards the MTO in 2015.

Based on the Commission's forecast (based on a no-policy-change assumption), the required adjustment for 2016 would be 0.5% of GDP, as the country would grow above potential and debt would exceed 60% of GDP. The expenditure benchmark would no longer be met, with a negative deviation of -0.4% of GDP against the requirement. The deviation based on the structural-balance pillar would be -0.9% of GDP and would continue to be significant over two years. The overall assessment shows that there would be a risk of significant deviation in the adjustment path towards the MTO in 2016.

The 2015 Stability Programme also plans a continued deterioration of the structural balance in 2015 and 2016, also pointing to a significant deviation from the required adjustment path. According to the programme, the MTO would not be reached by 2019.

Some deviation regarding the adjustment path towards the MTO had already been identified in the assessment of the 2014 Stability Programme. The government did not take measures to respond to the 2014 country-specific recommendation which called on it to take action within the 2014-2015 period to limit the emerging gap relative to the MTO and to ensure the return to it in 2015.

**Government expenditure and investment**

Government investment as a share of GDP has been increasing from the start of the crisis. In 2008, gross fixed capital formation by the government sector amounted to 3.6% of GDP. In 2013 it reached 4.2% of GDP and slightly receded in 2014 to 4.1% of GDP. According to the Stability Programme, investment is expected to amount to 4.3% of GDP in 2015 and 2016. Throughout the period, the general government deficit ratio in both headline and structural terms is lower than the government investment-to-GDP ratio. Overall, general government investment, as a share of GDP, is among the highest in the euro area.

Since 2012, Finland's general government has been in primary deficit. According to the Stability Programme, it is expected to remain in primary deficit over 2015-2016. Interest expenditure has been stable, as the effective interest rate paid on debt has decreased significantly in recent years. Interest expenditure, as a share of GDP, is forecast to fall over the forecast horizon.

[6] The negative "surprise" in inflation can be calculated as the difference between the GDP deflator for 2014 and the one forecast in the Commission's 2014 spring forecast. The effect on the structural balance is estimated at -¼% in this case. If the negative "surprise" in inflation is calculated as the difference between the GDP deflator for 2014 and the average forecast in the 2014 spring and autumn forecasts, the estimated effect is close to -1/3% of GDP.

Current expenditure, excluding interest, has been on an increasing trend. It has increased from 43.0% of GDP in 2008 to 53.9% in 2014. The increase is mainly driven by increases in social security expenditure. Other expenditure items have been relatively stable.

### Quality of public finances

Finland has enacted, in national law, the structural-budget-balance rule foreseen by the Fiscal Compact and enshrined specific implementing provisions in secondary legislation. Finland’s fiscal framework is tied to multiannual expenditure ceilings and has recently been strengthened by a provision obliging the central government to consider the impact of its policy measures on the fiscal balance of local authorities and social-security funds. However, there seems to be limited flexibility to react to challenges arising during the running year. If a growth forecast is revised significantly downwards during the year, as happened in 2013 and 2014, there is no process to adjust the expenditure limits accordingly.

The 2015 budget will test the operation of the structural-balance rule. According to the government forecast underlying the Draft Budgetary Plan for 2015, it became apparent that Finland would move away from its 0.5 % of GDP structural deficit target. The government decided that adjustment measures were necessary, but rather than modifying its 2015 budget proposal, it decided that the measures in the structural policy programme were sufficient.

## 4.3. Medium-term government debt position

### Long-term sustainability of public finances

The general government gross consolidated debt-to-GDP ratio stood at 59.3% of GDP in 2014. Based on the Commission's spring 2015 forecast, the debt is expected to rise to close to 80% of GDP by 2025 (based on the no-policy-change scenario, under the assumption that the structural primary balance position evolves according to the Commission's spring 2015 forecast until 2016), remaining above the 60%-of-GDP Treaty threshold. The increase would be driven by the costs of ageing.

Finland is assessed to be at low risk of fiscal stress in the short term, but is at high sustainability risk in the medium term and medium risk at long term due to the budgetary impact of the cost of ageing. The focus, therefore, should be on containing age-related expenditure growth further so as to contribute to the sustainability of public finances in the medium and long run. However, the latest pension reform agreed in autumn 2014 but not yet legislated by the Finnish parliament, is not included in these assessments.

Compared with 2014 projections, both the S2 and the S1 indicator have worsened.

### Stock-flow adjustment

The stock-flow adjustment has a large effect on changes in general government debt in Finland. This is because the earnings-related pension system, included in the general government sector, is partially pre-funded and is in surplus. The surplus stood at 1.9% of GDP in 2013 and at 1.4% of GDP in 2014. In 2015, the Stability Programme projects the surplus to diminish to 0.8% of GDP. The surplus is included in the general government balance but is not used to pay off general government debt. These funds show up as a net accumulation of assets in the stock-flow adjustment. Finland's general government net-financial-assets position is forecast to amount to 51.3% of GDP in 2014, down from 54.6% of

GDP in 2013[7]. The OECD projects net assets to amount to 45.2% of GDP by the end of 2016. Among OECD countries, it is one of the highest positive net-financial-asset positions.

**Total stock of debt guaranteed by the government**

Finland had central-government guarantees amounting to 19.0% of GDP in 2014. Among those, guarantees linked to the financial sector amounted to 1.2% of GDP in 2014. The bulk of the guarantees (12% of GDP) are issued to the non-financial corporations, mainly through the Finnvera corporation - a specialised state-owned financing company. Taking into account the strong position of the financial sector[8] and the low observed pay-outs from the guarantees, the risks associated with the debt guaranteed by the government do not appear to be significant.

### 4.4. Other factors considered relevant by the Commission

**Financial stabilisation operations**

Among the other factors considered relevant by the Commission, particular consideration is given to financial contributions to fostering international solidarity and achieving the policy goals of the Union, the debt incurred in the form of bilateral and multilateral support between Member States in the context of safeguarding financial stability and the debt related to financial-stabilisation operations during major financial disturbances (Article 2(3) of Regulation (EC) No 1467/97).

In assessing compliance with the debt criterion, financial assistance to euro-area Member States with a debt-increasing impact has been taken into account. According to the Commission's 2015 spring forecast, the cumulative impact of this assistance would amount to 2.9% of GDP in 2015. Thus, Finland's general government gross debt would be 58.3% of GDP in 2015 and 61.9% in 2016 if the debt related to financial-stabilisation operations was deducted.

### 4.5. Other factors put forward by the Member State

In a letter received by the Commission on 5 May 2015, the Finnish authorities emphasised that the Stability Programme is based on technical assumptions and not on the actual plans of the incoming government, which, at the time of the preparation of this report, is being formed based on the results of the 19 April elections.

The authorities explained that the breach of the 3% of GDP reference value in 2014 was not planned, as it was not evident in the relevant forecasts that it would occur, and similarly, the higher deficit in 2015 stems from the base effect of the deficit in 2014. At the time of drafting the 2015 budget, the forecasts indicated a deficit below 3% for 2015. Since the deficit was announced by the Statistical office, there has been no possibility to react to this development due to the elections. Moreover, the authorities note that the data for 2014 could be subject to further revisions.

As already considered in section 2 of the report, Finland argues that the impact of ESA 2010 and 3 years of negative growth warrant the conclusion that the excess over the 3% of GDP

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7 OECD Economic Outlook no 93, Annex Table 33.

8 As discussed in the 2015 Country Report http://ec.europa.eu/europe2020/pdf/csr2015/cr2015_finland_en.pdf

reference value was exceptional in 2014. If the ESA95 definition would be used, the deficit would be projected to remain at 3% of GDP in 2015.

The authorities further argue that the country should be considered, based on an overall assessment, compliant with the required adjustment towards the MTO in 2014. The deviation based on the structural balance pillar can be linked to the surprise outcome of the nominal balance, lower than expected inflation and to the decrease in interest income. In fact, according to the authorities, the net effect of decreasing interest rates increases Finland's government deficit by 0.15% of GDP, due to the loss of revenue from the assets that the general government sector holds. Regarding 2015, the authorities argue that an overall assessment could lead to the conclusion of broad compliance with the required adjustment towards the MTO.

Concerning the debt ratio, the authorities emphasize the role of the cyclical situation and the solidarity operations in the accumulation of debt. Finland also drew attention to the consolidation measures decided for 2015 and beyond and that due to the large positive net-asset position, Finland does not benefit, in net term, from the low interest-rate environment.

According to the calculations of the Finance Ministry (based on the 2015 Stability Programme), the debt level corrected for business-cycle effects would be 56.9% of GDP in 2015. Debt excluding the solidarity operations would amount to 58.2% of GDP in 2015 and it should therefore be concluded that the debt criterion is fulfilled in 2015.

Finally, Finland considers that any conclusions regarding the year 2016 are not warranted at this stage in the absence of a budget for 2016.

## 5. CONCLUSIONS

**Deficit criterion.** The general government deficit in Finland reached 3.2% of GDP in 2014 and is planned to stay above the 3% of GDP reference value over the forecast horizon, applying the no-policy-change assumption. The excess over the reference value is therefore not temporary while it is close to it. The deficit cannot be considered exceptional within the meaning of the Stability and Growth Pact for the period 2014-2016. When considering the relevant factors for 2014, it should be noted that there was an important deterioration in the structural balance in that year. However, on balance, the relevant factors seem to indicate that there are mitigating factors for the breach of the reference value in 2014. The high general government deficit reflects the impact of the changeover to ESA 2010. Although the increase of the deficit in 2014 cannot be linked to the increase in public investments in this year, Finland's public investment expenditure exceeds the deficit. However, in 2015 and 2016, the debt breaches the 60% of GDP reference value of the Treaty while the deficit remains above 3% of GDP. The medium-term budgetary position manifested in the structural balance strongly indicates that Finland is moving away from its MTO as the cyclical conditions improve over 2015-2016. Therefore, overall, the deficit criterion in the Treaty is not considered to be complied with.

**Debt criterion.** While general government gross debt was below 60% in 2014, the 2015 Stability Programme plans it to reach 62.5% of GDP in 2015, i.e. above the 60%-of-GDP reference value. Similarly, the Commission's spring 2015 forecast projects gross debt above the reference value at 62.6% of GDP in 2015 and 64.8% in 2016. As demonstrated in this report, while the planned breach of the debt criterion is fully explained by Finland's financial support to safeguard financial stability in the euro area in 2015, this would no longer be true in 2016. The debt level has been influenced by large purchases of financial assets by the social security funds, resulting in the accumulation of assets in parallel to the increase of debt. Finally, it should be noted that the debt ratio reflects the effects of Finland's current cyclical position, but also this factor cannot, by itself, explain the excess over the 60%-of-GDP reference value in 2016. Overall, the analysis presented in the report suggests that that the debt criterion is not considered to be complied with.

According to the April 2015 Stability Programme, the government formed following the April 2015 elections will draft a new general government fiscal plan/Stability Programme for 2016–2019 by September 2015. This plan will provide the opportunity to assess the measures that should be planned in order to bring the deficit below the 3% reference value and to put the debt ratio on an appropriate downward path.