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COMMISSION OPINION

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GENERAL CONSIDERATIONS

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

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

CONSIDERATIONS CONCERNING FINLAND

3. On the basis of the Draft Budgetary Plan for 2017 submitted on 13 October by Finland, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

4. The Commission opinion is to be seen in light of the latest economic and budgetary data. In this context, as indicated in the Commission recommendation for a Council Recommendation on the economic policy of the euro area as well as in the Commission Communication 'Towards a positive fiscal stance for the euro area', it is important that the aggregate fiscal stance of the euro area is positive and supports the ongoing recovery, while ensuring the long-term sustainability of national public finances.

5. Finland is subject to the preventive arm of the SGP and should ensure sufficient progress towards its medium term budgetary objective (MTO) of a 0.5% of GDP structural deficit. As the debt ratio was 63.6% of GDP in 2015 Finland also needs to comply with the debt reduction benchmark. In particular, the Council recommended Finland on 12 July 2016 to achieve an annual fiscal adjustment of at least 0.5 % of GDP towards the medium-term budgetary objective in 2016 and 0.6 % of GDP in 2017 and to use any windfall gains to accelerate the reduction of the general government debt ratio.

6. The macroeconomic scenario underpinning the Draft Budgetary Plan is plausible. While the Stability Programme submitted in April 2016 had forecast growth to reach 0.9% in 2016 and to accelerate to 1.2% in 2017, the Draft Budgetary Plan has increased growth expectations to 1.1% in 2016 and downgraded these to 0.9% in 2017. According to the Commission 2016 autumn forecast the Finnish economy would grow by 0.8% in 2016 as well as in 2017. Risks to the macroeconomic scenario are broadly balanced.

7. Finland complies with the requirement of Regulation (EU) No 473/2013 that the draft budget has to be based on independently endorsed or produced macroeconomic forecasts. The macroeconomic forecasts underlying the Draft Budgetary Plan have been produced by The Economics Department of the Ministry of Finance that is

functionally independent with regard to the forecast preparation according to the Finnish legislation. Finland is nevertheless the only Member State that uses such an arrangement.

8. For 2016, the Draft Budgetary Plan forecasts the headline deficit at 2.4% of GDP in 2016, 0.1 percentage points worse than in the April 2016 Stability Programme. For 2017, the Draft Budgetary Plan forecasts a significantly higher general government deficit than the April Stability Programme. In the April Stability Programme the deficit was forecast to decline to 2.1% of GDP in 2017, while the Draft Budgetary Plan expects the deficit to increase from 2.4% in 2016 to 2.6% in 2017. This is due to the effects of the labour market and tax reforms – the Competitiveness Pact – which are taken into account in the Draft Budgetary Plan. In structural terms, the Draft Budgetary Plan leads to a worsening of the recalculated structural balance by 0.3% of GDP in 2017. Based on the Draft Budgetary Plan, Finland's debt-to-GDP ratio is expected to increase from 65.3% in 2016 to 66.7% in 2017, broadly in line with the projections in the 2016 Stability Programme.

Based on the information included in the Draft Budgetary Plan, interest expenditure in Finland is expected to fall from 1.2% of GDP in 2015 to 1.1% in 2016 and is projected to decrease further next year, to 1.0% of GDP, well below the 1.4% of GDP recorded in 2012. However, the low interest rate environment reduces the revenues from government assets which are higher than the liabilities and therefore the lower interest rate environment does not bring about any net windfall gains.

9. In 2017, Finland is expected to continue to implement the consolidation measures envisaged in the government programme and the 2016 Stability Programme. According to the Draft Budgetary Plan, the measures on the expenditure side result in a 0.9% reduction of expenditure. However, as part of the Competitiveness Pact that extends annual working time and agrees on no wage increases for 2017, the Draft Budgetary Plan includes measures to lower personal income tax and employers' health insurance contributions. These measures lead to a revenue loss amounting to around 0.7% of GDP. Part (0.1%) of the short-term fiscal loss is mitigated by the lowering of public sector holiday bonuses by 30% over 2017-2019. Based on the Draft Budgetary Plan, the consolidation measures do not have a negative effect on public investments.

10. In its 2016 Stability programme Finland indicated that the budgetary impact of the exceptional inflow of refugees is significant and should be considered as an unusual event outside the control of the government, for the purposes of Article 5(1) and Article 6(3) of Regulation (EC) No 1466/97. More specifically, this expenditure is estimated at 0.2% of GDP in 2016. In relation to this, Finland requested a temporary deviation from the adjustment path towards the MTO of 0.2% of GDP in 2016. In the present Draft Budgetary Plan the government has revised slightly those projections to 0.3% of GDP. The provisions set out in Article 5(1) and Article 6(3) of Regulation (EC) No 1466/97 cater for this additional expenditure, in that the inflow of refugees is an exceptional event, its impact on Finland`s public finances is significant and sustainability would not be compromised by allowing for a deviation from the adjustment path towards the medium-term budgetary objective. The Commission will make a final assessment, including on the eligible amounts, in spring 2017 on the basis of observed data as provided by the authorities.

11. According to the Commission 2016 autumn forecast, Finland's output gap in 2016 is estimated at 1.8% of GDP. However, based on the screening tool developed by the

Commission in consultation with the Member States, there are indications that the output gap estimated for Finland on the basis of the commonly agreed methodology may be counterintuitive. The results of the detailed assessment of the output gap estimate for 2016 imply that Finland would meet the minimum benchmark in 2017.

12. The Draft Budgetary Plan is accompanied by a formal request to avail of the flexibility under the preventive arm pursuant to the "Commonly agreed position on Flexibility within the Stability and Growth Pact" endorsed by the ECOFIN Council in February 2016 in view of the planned implementation of major structural reforms with a positive impact on the long-term sustainability of public finances (request for 0.5% of GDP flexibility) and national expenditures on projects co-financed by the EU under the European Structural and Investment Funds (request for 0.1% of GDP flexibility).

On the basis of the Commission 2016 autumn forecast, it appears that the eligibility criteria for the structural reforms and investment clause are not fulfilled. Finland does not appear to meet the minimum benchmark which is designed to ensure sufficient safety margin towards the 3% of GDP reference value of the Treaty. However, the results of the detailed assessment of the output gap estimate for 2016 imply that Finland would meet the minimum benchmark in 2017. As an additional assurance to safeguard the 3% of GDP deficit reference value, Finland's government has publicly committed to take the additional measures in 2017, if necessary, to ensure compliance with the fiscal rules, including the observance of the 3% of GDP reference value of the Treaty in 2017. The complete assessment of the request for flexibility will take place within the normal European Semester cycle in the context of the assessment of the 2017 Stability Programme.

13. The Commission 2016 autumn forecast takes into account the impact of the Competitiveness Pact and expects the deficit to increase to 2.5% of GDP in 2017. The difference with the Draft Budgetary Plan is due to the Commission's somewhat more favourable assumption on revenues and lower investments forecast on the expenditure side. The Commission forecast similarly points to a worsening in structural balance in 2017 and continued increase in the debt-to-GDP ratio. Risks to the deficit and debt forecast stem from the uncertainties surrounding the magnitude and timing of the expected positive employment effects generated by the Competitiveness Pact and from the external environment.

14. As the debt ratio was 63.6% of GDP in 2015 Finland needs to comply with the debt reduction benchmark. In 2016, gross debt ratio is expected to reach 65.4% based on the Commission 2016 autumn forecast which *prima facie* indicates that the 60% treaty reference value is not being complied with. In 2017 Finland is not projected to be compliant with the debt benchmark (gap of 1.6%).

15. On 18 May 2016, the Commission issued a report under Article 126(3) of the TFEU, as Finland's general government debt exceeded 60% of GDP in 2015. The report concluded that, after the assessment of all relevant factors, the debt criterion should be considered being complied with.

16. Based on the Draft Budgetary Plan, the recalculated structural balance is projected to worsen by 0.1% in 2016, pointing to a significant deviation (0.6% of GDP) from the preventive arm requirement. By contrast, the growth rate of government expenditure, net of discretionary revenue measures, in 2016 is not expected to exceed the applicable expenditure benchmark rate. The difference between the two pillars is mainly explained by the revenue shortfalls negatively affecting the structural

balance, a difference in the potential growth benchmarks used and the effect of lower-than-expected inflation. On balance, the overall assessment points to a risk of some deviation from the required adjustment towards the MTO. If the current estimate of the budgetary impact in 2016 of the exceptional inflow of refugees were deducted, the assessment would point to compliance. The overall assessment based on the Commission forecast confirms the results of the assessment for 2016 based on the Draft Budgetary Plan.

In 2017, the Draft Budgetary Plan projects a 0.3% of GDP worsening in the recalculated structural balance, pointing to risk of significant deviation (gap of 0.9% of GDP) from the required adjustment in 2017. The expenditure benchmark also points to a significant deviation in 2017 (gap of 0.9% of GDP). The overall assessment concludes on a risk of significant deviation from the adjustment path towards the MTO. The analysis based on the Commission 2016 autumn forecast broadly confirms these results.

17. Finland's Draft Budgetary Plan contains, as part of the reform measures to increase Finland's cost-competitiveness, measures to reduce the tax wedge such as the reduction of personal income tax and reduction of employers' as well as employees' social contributions. The reform contains an overall unfinanced reduction of taxes and contributions and all the reform measures are expected to be in force as of 2017. The lowering of labour costs by about 4% is expected to improve Finland's cost-competitiveness. According to the Draft Budgetary Plan, the legislative documents needed for the reform of the health and social care system have been completed and public consultation has started. This development allows the reform, which corresponds to the country-specific recommendation, to be on track to enter into force as of 2019.

18. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Finland, which is currently under the preventive arm, is at risk of non-compliance with the provisions of the SGP. In particular, according to the Commission 2016 autumn forecast there is a risk of significant deviation from the required adjustment path towards the MTO in 2017. The Commission will continue to monitor closely Finland's compliance with the obligations under the SGP, notably in connection with the assessment of the next Stability Programme. In the context of the overall assessment of a possible deviation from the adjustment path towards the MTO in 2017, the Commission will take into account the above considerations on Finland's possible eligibility for flexibility under the SGP. Particular attention will be paid to the existence of credible plans for the resumption of the adjustment path towards the MTO and to progress made with the structural reform agenda, taking into account the country-specific recommendations adopted by the Council on 12 July 2016. In line with the Commission Communication 'Towards a positive fiscal stance for the euro area', the Commission invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2017 budget will be compliant with the SGP.

The Commission is also of the opinion that Finland has made some progress with regard to the structural part of the fiscal country-specific recommendations issued by the Council in the context of the 2016 European Semester and invites the authorities to make further progress. A comprehensive assessment of progress made in the implementation of the country-specific recommendations will be made in the 2017 country reports and in the context of the country-specific recommendations to be adopted by the Council in 2017.

Done at Brussels, 16.11.2016

For the Commission
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