Council of the
European Union

Brussels, 22 May 2017
(OR. en)

9237/17

ECOFIN 370
UEM 119
SOC 348
EMPL 263
COMPET 365
ENV 465
EDUC 193
RECH 149
ENER 189
JAI 440

COVER NOTE

From:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
date of receipt:	22 May 2017
To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
No. Cion doc.:	COM(2017) 525 final
Subject:	Recommendation for a COUNCIL RECOMMENDATION on the 2017 National Reform Programme of Finland and delivering a Council opinion on the 2017 Stability Programme of Finland

Delegations will find attached document COM(2017) 525 final.

Encl.: COM(2017) 525 final

EUROPEAN
COMMISSION

Brussels, 22.5.2017
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Recommendation for a

COUNCIL RECOMMENDATION

on the 2017 National Reform Programme of Finland

and delivering a Council opinion on the 2017 Stability Programme of Finland

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Recommendation for a

COUNCIL RECOMMENDATION

on the 2017 National Reform Programme of Finland

and delivering a Council opinion on the 2017 Stability Programme of Finland

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies,[1] and in particular Article 5(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances,[2] and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,[3]

Having regard to the resolutions of the European Parliament,[4]

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 16 November 2016, the Commission adopted the Annual Growth Survey,[5] marking the start of the 2017 European Semester of economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 9-10 March 2017. On 16 November 2016, on the basis of Regulation (EU)

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1 OJ L 209, 2.8.1997, p. 1.
2 OJ L 306, 23.11.2011, p. 25.
3 COM(2017) 525 final.
4 P8_ TA(2017)0038, P8_ TA(2017)0039, and P8_ TA(2017)0040.
5 COM(2016) 725 final.

No 1176/2011, the Commission adopted the Alert Mechanism Report,[6] in which it identified Finland as one of the Member States for which an in-depth review would be carried out. On the same day, the Commission also adopted a recommendation for a Council Recommendation on the economic policy of the euro area. That Recommendation was endorsed by the European Council on 9-10 March 2017 and adopted by the Council on 21 March[7].

(2) As a country whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Finland should ensure the full and timely implementation of the Recommendation for the euro area which is reflected in recommendations 1 to 2 below.

(3) The 2017 country report for Finland[8] was published on 22 February 2017. It assessed Finland's progress in addressing the country-specific recommendations adopted by the Council on 12 July 2016, the follow-up given to the recommendations adopted in previous years and Finland's progress towards its national Europe 2020 targets. It also included an in-depth review under Article 5 of Regulation (EU) No 1176/2011, the results of which were also published on 22 February 2017.[9] The Commission's analysis leads it to conclude that Finland is not experiencing macroeconomic imbalances.

(4) On 28 April 2017, Finland submitted its 2017 National Reform Programme and its 2017 Stability Programme. To take account of their interlinkages, the two programmes have been assessed at the same time.

(5) The relevant country-specific recommendations have been taken into account in the Member States' programmes for the European Structural and Investment Funds (ESI Funds) covering the 2014-2020 period. As foreseen in the legislation governing the ESI Funds,[10] where it is necessary to support the implementation of relevant country-specific recommendations, the Commission may request a Member State to review and amend its relevant ESI Funds programmes. The Commission has provided further guidelines on the application of those rules.[11]

(6) Finland is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. In its 2017 Stability Programme, the government plans a deterioration in the headline balance from -1.9% of GDP in 2016 to -2.3% in 2017, followed by steady improvement thereafter, reaching -0.2% in 2020. The medium-term budgetary objective — a deficit of 0.5% of GDP in structural terms — is

6 COM(2016) 728 final.
7 2017/C92/01.
8 SWD(2017) 91 final.
9 COM(2017) 90 final.
10 Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006, OJ L 347, 20.12.2013, p. 320.
11 COM(2014) 494 final.

projected to be met from 2019 onwards. However, based on the recalculated[12] structural balance, the medium-term budgetary objective will only be achieved as of 2020. According to the Stability Programme, the general government debt-to-GDP ratio is expected to peak at 64.7% in 2017 and to decline to 62.7% in 2020. The macroeconomic scenario underpinning these budgetary projections appears to be favourable especially regarding 2018 and 2019. The scenario is based on an expectation that employment would expand by close to 2% per year in 2018-2019 which is significantly more than the annual average increase over the past 10 years (+0.2%).

(7) On 22 May 2017, the Commission issued a report under Article 126(3) of the TFEU, as Finland's general government debt exceeded the 60%-of-GDP reference value. The report concluded, following an assessment of all the relevant factors, that the debt criterion should be considered as complied with.

(8) The 2017 Stability Programme indicates that the budgetary impact of the exceptional inflow of refugees is significant and provides adequate evidence of the scope and nature of these additional budgetary costs. According to the Stability Programme, the costs were 0.34% of GDP in 2016. According to the Commission, the eligible additional expenditure in 2016 amounted to 0.17% 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 unusual event, its impact on Finland's public finances is significant and sustainability would not be compromised by allowing for a temporary deviation from the adjustment path towards the medium-term budgetary objective. Therefore, the required adjustment towards the medium-term budgetary objective for 2016 has been reduced to take into account these costs. According to the 2017 Stability Programme, the costs related to the exceptional inflow of refugees are projected to decrease by 0.15% of GDP in 2017. The Commission will make a final assessment on 2017, including on the eligible amounts, in spring 2018 on the basis of observed data as provided by the authorities.

(9) In its 2017 Draft Budgetary Plan,[13] Finland requested 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).

(10) The request for flexibility for structural reforms refers to reforms in the labour market, in particular the Competitiveness Pact and the pension reform. For more than 90% of employees, the Pact freezes wages for 12 months, and permanently increases the annual working time by 24 hours without compensation. In addition, employees will permanently pay a larger proportion of the contributions to social security. To compensate for the wage freeze and the increased cost burden for employees, the government lowered the taxes on earned income permanently as from 2017. The pension reform will raise the lowest statutory retirement age from 63 to 65 by 2027; thereafter, the retirement age will be linked to life expectancy. Both reforms came

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

13 Ministry of Finance publications 36c/2016.

into force in 2017. As a result of the Competitiveness Pact, improved cost competitiveness could lead to higher employment and an increase in real GDP of some 1.5%-2% as presented in the 2017 draft budgetary plan. Given the nature of the measure, there are uncertainties surrounding the estimates for employment or GDP, but they seem to be broadly plausible. Therefore, these reforms will have a positive impact on the sustainability of public finances. Furthermore, the results of the detailed assessment of the output gap estimate for 2017 carried out on the basis of the Commission 2017 spring forecast imply that Finland meets 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 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.[14] On this basis, Finland can currently be assessed as qualifying for the requested temporary deviation of 0.5% of GDP in 2017, provided that it adequately implements the agreed reforms, which will be monitored under the European Semester.

(11) Regarding the request for flexibility for additional investment, the information provided by the 2017 Stability Programme appears to confirm that Finland's temporary deviation from the adjustment path towards the medium-term budgetary objective in 2017 is being effectively used for the purposes of increasing investments. Therefore, and also taking into account the above-mentioned elements regarding the minimum benchmark and that the detailed assessment of the output gap estimate confirms that Finland is experiencing bad economic times, Finland can currently be assessed as qualifying for a temporary deviation of 0.1% of GDP in 2017 to take account of national investment expenditure in projects co-financed by the EU. The Commission will carry out an ex post assessment in order to verify the actual amount of the national expenditure in co-financed investment projects and of the related allowance.

(12) On 12 July 2016, the Council recommended Finland to achieve an annual fiscal adjustment of at least 0.6% of GDP towards the medium-term budgetary objective in 2017. While ensuring a continued respect of the minimum benchmark (i.e. a structural deficit of 1.1% of GDP), the Commission 2017 spring forecast indicates scope for an additional temporary deviation of 0.6% of GDP in 2017 under the structural and investment clauses. On that basis, the structural balance would be allowed to deteriorate by 0.5% of GDP in 2017. Based on the Commission 2017 spring forecast, Finland would be compliant with the preventive arm requirements. If the current updated estimate of the decrease of the budgetary impact in 2017 stemming from the exceptional inflow of refugees were taken into account, the conclusion of the overall assessment would not change. For 2018, Finland should achieve its MTO, taking into account the allowance in relation to unusual events (granted for 2016) as well as the allowances related to the implementation of the structural reforms and investments (granted for 2017).[15] Based on the Commission 2017 spring forecast, this is consistent with a maximum nominal growth rate of net primary government expenditure[16] of 1.6%, corresponding to an annual structural

[14] VM/712/04.00.05.01/2016.

[15] Finland is allowed to deviate from its medium-term budgetary objective in 2018 because temporary deviations are carried forward for a period of three years.

[16] Net government expenditure is comprised of total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital

adjustment of 0.1% of GDP. Under unchanged policies, Finland would be compliant with the preventive arm requirements in 2018. If the current updated estimate of the decrease of the budgetary impact in 2017 stemming from the exceptional inflow of refugees were taken into account, the conclusion of the overall assessment would not change. At the same time, Finland is prima facie forecast not to comply with the debt reduction benchmark in 2017 and 2018. Overall, the Council is of the opinion that Finland needs to stand ready to take further measures to ensure compliance.

(13) Due to an ageing population and a declining workforce, expenditure on pensions, health and long-term care is set to increase from 23 % of GDP in 2013 to 27 % by 2030. In January 2017, a pension reform entered into force that will raise the lowest statutory retirement age from 63 to 65 by 2027 and will link the statutory retirement age to changes in life expectancy. The costs of social and healthcare services, currently a responsibility of the municipalities, amount to 10 % of GDP. Without a reform of the system, that expenditure is forecast to grow by 2.4 % annually in the coming years in nominal terms and increase as a share of GDP. The reforms' main aims include the reduction of the long-run sustainability gap in public finances through better control of the costs. This will be achieved through the integration of services, larger entities as providers of services and digitalisation. The first batch of legislative proposals for the social and healthcare service reforms was presented to the parliament in March 2017. These laws will establish the legal framework for the 18 new counties that will take over responsibility for the social and healthcare services from the municipalities as from 2019. The legislative proposals for the most controversial parts of the reform, in particular on the patients' freedom to choose their service provider, still need to be finalised because of the reform being implemented from 2019 as planned.

(14) Wage increases have been moderate over recent years. The average year-on-year increase in negotiated wages was 0.7 % in 2014-2016. Due to weak growth of labour productivity, cost competitiveness has improved only gradually. In 2016 the social partners signed the Competitiveness Pact aimed at improving Finland's cost competitiveness in a stepwise manner in 2017. For more than 90 % of employees, the Pact freezes wages for 12 months and increases annual working time permanently by 24 hours without additional compensation. In addition, employees will permanently pay a larger proportion of social contributions. These measures are expected to support the expansion of exports and employment in the coming years. The upcoming wage negotiation round in the latter half of 2017 will be crucial to secure these expected positive effects as the Pact did not fully close the cost competitiveness gap to peer economies.

(15) The labour market situation started to improve gradually in 2016, but challenges remain. Employment in the manufacturing sector declined by 21 % between 2008 and 2015. Other sectors such as construction, real estate and healthcare, are showing signs of labour shortages. This highlights the need for targeted active labour market policies and continued investments in adult learning and in vocational training to enable occupational mobility. The open vacancies-to-employment ratio was in 2016 almost as high as in 2007, while the unemployment rate was two percentage points

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formation is smoothed over a 4-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.

higher. This may reflect mismatches between labour demand and supply, low attractiveness of certain vacant jobs or limited incentives to take up work. Continued efforts are needed to ensure better labour market outcomes for the inactive, especially those in the 25-39 age group, the long-term unemployed and migrants. Ensuring improved social and labour market outcomes of people with migrant background will also require continued investments in their education.

(16) In terms of activation, the complex benefits system with its different types of allowances can result in significant inactivity and low wage traps, as well as bureaucratic problems on reinstating of benefits. It would be crucial to address these traps. To increase the incentives to accept job offers, the obligation for the unemployed to accept a job offer and the obligation to participate in activation schemes have been tightened. In addition, the duration of earnings-related unemployment benefits was reduced. Positive incentives, such as allowing the use of basic unemployment benefit as mobility and wage subsidies to activate jobseekers, were introduced. Further increased incentives to accept work could be complemented with the elimination of existing bureaucratic barriers to take up a job or to become an entrepreneur.

(17) Non-cost competitiveness acts as a drag on export performance and may limit the attractiveness of Finland for foreign investors. Structural change is unfolding, but has slowed down recently. Progress has been made in opening up services sectors such as retail trade and transport to competition, and proposals have been put forward to increase competition in other domestic service sectors. While international comparisons rank Finland among the leading countries in the world in terms of its business environment and investment appeal, the existing stock of inward investments in Finland is below the EU average when compared to the size of the economy.

(18) In the context of the European Semester the Commission has carried out a comprehensive analysis of Finland’s economic policy and published it in the 2017 country report. It has also assessed the Stability Programme and the National Reform Programme and the follow-up given to the recommendations addressed to Finland in previous years. It has taken into account not only the relevance of the programmes and follow-up measures for sustainable fiscal and socioeconomic policy in Finland, but also their compliance with EU rules and guidance, given the need to strengthen the EU’s overall economic governance by providing EU-level input into future national decisions.

(19) In the light of this assessment, the Council has examined the Stability Programme and its opinion[17] is reflected in particular in recommendation 1 below,

HEREBY RECOMMENDS that Finland take action in 2017 and 2018 to:

1. Pursue its fiscal policy in line with the requirements of the preventive arm of the Stability and Growth Pact, which implies to achieve its medium term budgetary objective in 2018, taking into account the allowances linked to unusual events, the implementation of the structural reforms and investments for which a temporary deviation is granted. Ensure timely adoption and implementation of the administrative reform to improve cost-effectiveness of social and healthcare services.

[17] Under Article 5(2) of Council Regulation (EC) No 1466/97.

2. Promote the further alignment of wages with productivity developments, fully respecting the role of social partners. Take targeted active labour market policy measures to address employment and social challenges, provide incentives to accept work and promote entrepreneurship.

3. Continue to improve the regulatory framework and reduce the administrative burden to increase competition in services and to promote investment.

Done at Brussels,

For the Council
The President