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From:	Jani Pitkäniemi, Counsellor, Permanenet Representation of Finland to the European Union
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To:	Carsten Pillath, Director-General, DGG-Economic Affairs and Competitiveness General Secretariat of the Council of the European Union
Subject:	Finland's Stability Programme 2014

Delegations will find attached Finland's Stability Programme for 2014.

PERMANENT REPRESENTATION OF
FINLAND TO THE EUROPEAN UNION

EUE Kauttu Katja(UM)

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Council of the European Union
General Secretariat
DG G Economic Affairs and Competitiveness
Director-General
Mr. Carsten PILLATH
Rue de la Loi 175
B-1048 Brussels

Ref.

Subject
Finland's Stability Programme 2014

Dear Sir,

We have the pleasure to transmit Finland's Stability Programme 2014 to your services.
Please find attached the document in Finnish and in English.

Yours sincerely,

Jani PITKÄNIEMI
Counsellor

Enclosures
Finland's Stability Programme 2014

cc

SECRETARIAT DU CONSEIL
DE L'UNION EUROPÉENNE
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Finland´s Stability Programme 2014

Economic outlook and economic policy

17c/2014

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Abstract

The Stability Programme is based on Prime Minister Katainen's Government Programme, the Budget approved by Parliament on 20 December 2013 and the General Government Fiscal Plan for 2015–2018, approved by the Government on 3 April 2014, and the forecasts on which this was based.

Finland's GDP is projected to grow by 0.5 per cent in 2014. In the medium term, GDP growth is expected to remain subdued. The forecast for average GDP growth in 2014–2018 is 1.3 per cent.

Despite the modest growth outlook, the state of Finland's general government finances will improve during the programme period. In 2013 the general government deficit was 2.1 per cent of GDP. Adjustment measures decided by the Government will particularly improve the central government budgetary position, such that, in accordance with the forecast presented in this Stability Programme, the general government budgetary position will balance by 2017 and the general government debt-to-GDP ratio will start to fall during the programme period.

Population ageing will adversely affect conditions for economic growth, increase central government age-related expenditure and inevitably weaken the general government budgetary position. The long-term sustainability gap in general government finances is estimated to be 3.0 per cent of GDP.

The 2013 Stability Programme set a medium-term objective of -0.5 per cent of GDP for the general government structural budgetary position and this was expected to be achieved in 2014. In 2013 the structural budgetary position was -0.4 per cent of GDP. In accordance with an assessment presented in this Stability Programme, the structural budgetary position will be -0.7 per cent of GDP in 2014. As a result of the adjustment measures decided by the Government, the structural budgetary position will strengthen during the programme period and will show a surplus in 2017.

In its winter forecast of February 2014, the Commission considered that Finland's fiscal deficit would be 2.4 per cent of GDP in 2013 and that Finland's structural budgetary position would deviate significantly from the medium-term objective in 2014 and 2015. After the publication of the Commission's forecast, it turned out, however, that the deficit in 2013 was 2.1 per cent of GDP. In addition, in March 2014 the Finnish Government agreed on extensive fiscal adjustment measures and also on the implementation of a Structural Policy Programme, adopted in the autumn 2013, as part of the General Government Fiscal Plan. The Structural Policy Programme includes significant structural reforms directed at fiscal management and public service provision, which will strengthen fiscal sustainability in the long term. The forecast presented in the Stability Programme takes into account the latest statistical data [1] as well as Government decisions and it concludes with the assessment that risk of a significant deviation with respect to Finland will not arise.

[1] In this Stability Programme, data published by Statistics Finland on 3 March 2014 has been used. The programme has not taken into account the revised data in Statistics Finland's EDP reporting of 31 March 2014.

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Introduction

Stability and convergence programmes provided under the Stability and Growth Pact form the basis for the multilateral monitoring of the EU's fiscal policy and the coordination of economic policy.

According to new EU rules, Member States are required to prepare a medium-term budgetary framework providing for the adoption of a fiscal planning horizon of at least three years. Member States must publish annually their national medium-term fiscal plans in line with their medium-term budgetary framework. The General Government Fiscal Plan approved by the Government on 3 April 2014 fulfils these requirements.

The General Government Fiscal Plan in 2014 is part of Finland's Stability Programme for 2014—18. The Stability Programme contains, in addition to this introduction, the following items in conformity with the General Government Fiscal Plan

— a description of the provisions and objectives steering fiscal management as well as the Government's fiscal policy by which the achievement of these objectives will be pursued
— a macroeconomic forecast and an assessment of the fiscal outlook over the parliamentary term and beyond, in which the assessment of general government finances is based on independent, up-to-date and realistic estimates of real economic prospects during the parliamentary term
— a presentation of the key measures directed at general government revenue and expenditure as well as an assessment of the progress of structural reforms
— the Central Government Spending Limits Decision
— macroeconomic steering of local government, based on a summary of the Basic Public Services Programme.

The sensitivity analysis and tables belonging to the Stability Programme are presented in the appendices. The information presented in Chapters 1-7 of the General Government Fiscal Plan are based on National Accounts figures if not otherwise stated, while EDP figures are reported in the tables of Appendix 6.

Finland's general government finances consist of central government, local government and the social security funds, which are further divided into earnings-related pension funds, which handle statutory earnings-related pension insurance, and other social security funds.

The 2013 Stability Programme set a medium-term objective of -0.5 per cent of GDP for the general government structural budgetary position. The objective is in accordance with both the Stability and Growth Pact and the national FIPO Act, and it was approved by the Council in June 2013. The same Stability Programme included an assessment that the medium-term objective will be achieved in 2014. The Commission considered that Finland achieved the medium-term objective in 2012, when structural budgetary position was estimated to have been -0.7 per cent of GDP, which in the Commission's view is sufficiently close to the objective. In Finland's draft budgetary plan of October 2013, the structural budgetary position was estimated to be -0.7 per cent of GDP in 2013 and 2014, in other words the medium-term objective would have been maintained.

This Stability Programme estimates that Finland's structural budgetary position was -0.4 per cent of GDP in 2013, which would mean that Finland would have achieved the medium-term objective already one year earlier than expected. In the Commission's winter forecast, the 2013 structural budgetary position was -0.9 per cent of GDP, which is a deviation from the medium-term objective. This is not a significant deviation, however. [1]

According to the forecast presented in this Stability Programme, the structural budgetary position will be in 2014 -0.7 per cent and in 2015 -0.1 per cent of GDP. This deviates clearly from the assessment of the Commission's winter forecast, according to which Finland's structural deficit would rise in 2014 to -1.2 per cent and in 2015 to -1.4 per cent of GDP, both of which represent a significant deviation from the medium-term objective.

In its winter forecast of February 2014, the Commission considered that Finland's fiscal deficit would be 2.4 per cent of GDP in 2013. After the publication of the Commission's forecast, it turned out, however, that the deficit in 2013 was 2.1 per cent of GDP. In addition, in March 2014 the Finnish Government agreed on extensive fiscal adjustment measures and also on the implementation of a Structural Policy Programme, adopted in the autumn 2013, as part of the General Government Fiscal Plan. The Structural Policy Programme includes significant structural reforms directed at fiscal management and public service provision, which will strengthen fiscal sustainability in the long term. The forecast presented in the Stability Programme takes into account the latest statistical data[2] as well as Government decisions and it concludes with the assessment that risk of a significant deviation with respect to Finland will not arise.

On 29 August 2013, the Government decided on a Structural Policy Programme and set the objectives for it. On 29 November 2013, the Government specified the details of the

[1] In the event of a significant deviation from the medium-term objective being observed, the Commission shall address a warning to the Member State concerned in order to prevent the occurrence of an excessive deficit, after which the Council shall adopt recommendations for the Member State concerned to initiate effective measures to correct the situation within a deadline. If Council considers that the Member State concerned has failed to take appropriate action within the deadline, a non-interest-bearing deposit may be requested from the Member State until the situation is corrected.

[2] In this Stability Programme, data published by Statistics Finland on 3 March 2014 has been used. The programme has not taken into account the revised data in Statistics Finland's EDP reporting of 31 March 2014.

programme and decided on its implementation. The Government supplemented its earlier decisions and on 25 March 2014 decided [3] on the implementation of the programme as part of the General Government Fiscal Plan. The central government spending limits include those Government Structural Policy Programme measures that have cost impacts and whose preparation is at this stage sufficiently advanced. These measures are presented in Section 5.3.

The measures of the Structural Policy Programme can be grouped into five areas: balancing local government finances, improving the productivity of public service provision, working careers and supply of labour, structural unemployment and the output potential of the economy. The measures of the Structural Policy Programme are presented in Section 4.3.

To restore balance to local government finances municipalities' duties and the obligations prescribed on the basis of them, are reassessed so that a EUR 1 billion reduction in municipalities' operating expenditure is achieved at 2017 prices. In addition, the goal is achieve a EUR 1 billion saving in the municipalities at the 2017 prices through municipalities' own measures, for example by improving productivity and through tax revenue. A local government budgetary framework will create conditions to reconcile municipalities' duties and obligations as well as their funding, such that the local government budgetary position remains in balance in the medium term. Provisions relating to the steering of local government finances as well as the setting of sector-specific budgetary targets and a local government spending limit will come into force on 1 January 2015.

In improving the productivity of public service provision, a key role will be played by the social and health care services reform, which has been agreed between the Government parties and the opposition parties. The intention of the reform is for all social and health care services to be delivered by five strong regional providers. These five regions will be based on the current specific catchment areas and on currently well-functioning structures. The horizontal and vertical integration of social and health services as well as the sufficiently large population bases of the catchment areas will create great potential for operational efficiencies and productivity improvements in public service provision, which will improve the sustainability of public finances significantly in the long term. The objective is to complete the preparation of a Government proposal by the end of May and to circulate it for comment in June. The proposal will be submitted to Parliament in autumn 2014. The plan is for the new regions responsible for social and health care services to start operating on 1 January 2017.

In the Structural Policy Programme, the Government has set as an objective the extension of working careers at the start by ½ a year and at the end by 1½ years. In addition, the programme includes many reforms aimed at reducing career breaks and under-employment during working careers. Social partners will negotiate on pension reform. They are committed to achieving a reform that with sufficient certainty can be expected to reduce the general government sustainability gap by just over 1 percentage point. In addition, social partners are committed to completing the details of the reform by autumn 2014, so that the reform can come into force at the beginning of 2017.

[3] Government decision on implementing the Structural Policy Programme as part of the General Government Fiscal Plan, 25 March 2014. http://valtioneuvosto.fi/tiedostot/julkinen/kehysneuvottelut-2014/paatos/fi.pdf

The goal of Government reforms to improve the functioning of the labour market is to reduce structural unemployment by one percentage point. If it is found that the measures decided to date are insufficient to achieve the target, the Government is committed to specifying together with social partners new measures to ensure that the target is achieved.

To improve the output potential of the economy, measures will be directed at the housing market, digitalisation and ICT utilisation, appeal and permit procedures, and the programme for promoting health competition.

Broad Economic Policy Guidelines

In 2010 the European Council decided on a new economic and employment strategy. The strategy aims to strengthen employment, productivity and social cohesion and to create for the EU a smart, sustainable and inclusive economy. The strategy sets EU-wide targets for employment, research and development expenditure, climate policy, education and reducing poverty. The current broad economic policy guidelines and employment guidelines were approved in 2010 and they are valid until 2014. Based on these headline targets, Member States set their national targets and specify obstacles to economic growth. More detailed measures to achieve the targets and to remove obstacles to growth are presented in the Europe 2020 national reform programmes prepared by the Member States.

Finland's Europe 2020 Strategy National Reform Programme was submitted in April 2013. The programme set as Finland's national targets the raising of the employment rate of 20–64 year-olds to 78 per cent, maintaining R&D spending at a minimum of 4 per cent of GDP, reaching the climate and energy targets agreed in the EU, raising the proportion of 30–34 year-olds having completed tertiary-level education to 42 per cent, reducing the proportion of early school leavers to 8 per cent and reducing the number of people living at risk of poverty and social exclusion. Finland's national targets exceed the headline targets set in the EU.

After assessing Finland's National Reform Programme for 2013 as well as Finland's Stability Programme for 2013—2017, the Council recommended for Finland in June 2013 the following measures for 2013—2014:

1. Pursue a growth-friendly fiscal policy and preserve a sound fiscal position as envisaged, ensuring compliance with the medium-term budgetary objective over the programme horizon; continue to carry out annual assessments of the size of the ageing-related sustainability gap and adjust public revenue and expenditure in accordance with long-term objectives and needs; ensure the cost-effectiveness and sustainability of long-term care and put a stronger focus on prevention, rehabilitation and independent living.
2. Ensure effective implementation of the on-going administrative reforms concerning the municipal structure, in order to deliver productivity gains and cost savings in the provision of public services, including social and health care services.
3. Take further steps to increase the employment rate of older workers, including by improving their employability and reducing early exit pathways, and align the minimal statutory retirement age with increased life expectancy; implement and monitor closely the impact of on-going measures to improve the labour-market position of young peo-

ple and the long-term unemployed, with a particular focus on the development of job-relevant skills.

4. Continue efforts to enhance competition in product and service markets, especially in the retail sector, by implementing the new programme on promoting healthy competition.
5. Boost Finland's capacity to deliver innovative products, services and high-growth companies in a rapidly changing environment, and continue diversification of the industry towards less energy intensive sectors; in the current low-growth environment, support the alignment of real wage and productivity developments whilst fully respecting the role of social partners and in line with national practices.

Stability Programme update in 2014 and its handling in Finland

The Stability Programme is based on the Budget approved by Parliament on 20 December 2013 and the General Government Fiscal Plan for 2015—2018 adopted by the Government on 3 April 2014, which contains within it the Central Government Spending Limits Decision, and the forecasts on which this was based.

The document will be delivered to the relevant EU bodies once it has been approved by the Government in plenary session. The contents of the Stability Programme have also been presented in writing and orally to the Grand Committee of Parliament. The Commission's assessment and the Council's statement on Finland's Stability Programme will be submitted to Parliament in connection with Ecofin preparations.

Stability Programme complies with the Code of Conduct endorsed by Ecofin in September 2012.

1 Provisions guiding the management of general government finances

1.1 EU provisions

EU provisions, particularly the Stability and Growth Pact, set the framework for the management of general government finances in the Member States. The preventive arm of the Stability and Growth Pact ensures that fiscal policy is sustainable over a normal economic cycle, while the corrective arm specifies a framework within which countries initiate corrective measures in the event of an excessive deficit. An excessive deficit arises when countries violate one or both of the rules of the EU treaties that the deficit must not exceed 3 per cent of GDP and general government debt must not exceed 60 per cent of GDP.

Budgetary target-setting is guided by the medium-term objective for the general government budgetary position. Its role is to ensure a safety margin with respect to the 3 per cent deficit limit and the rapid achievement of sustainability. Each Member State sets its own medium-term objective. Compliance with the objective must be included within national medium-term budgetary frameworks.

The state of Member States' public finances, the suitability of objectives and progress towards achieving them are monitored and assessed within the framework of the European Semester.

The General Government Fiscal Plan fulfils the requirements of the budgetary framework according to Directive 2011/85/EU as well as the medium-term fiscal plan according to the Regulation for monitoring and assessing draft budgetary plans EU No 473/2013.

The General Government Fiscal Plan forms the basis of Finland's Stability Programme in 2014.

1.2 National provisions

The General Government Fiscal Plan is prepared in accordance with a Government Decree (120/2014). The basis of the decree is the so-called FIPO Act (Act on the implementation of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, the implementation of Treaty provisions of a legislative nature as well as requirements concerning multi-annual budgetary frameworks, 869/2012), in which is prescribed an objective for the structural budgetary position and a correction mechanism for achieving the objective.

The purpose of the General Government Fiscal Plan is to support decision-making relating to general government finances as well as compliance with the medium-term objective set for the general government structural budgetary position. The General Government Fiscal Plan covers the whole of general government finances, including the parts relating to central government finances, local government finances, statutory pension providers and other social security funds. The Government prepares the General Government Fiscal Plan for the parliamentary term and revises it annually for the following four years by the end of April.

2 Targets guiding the management of general government finances and the government's fiscal policy line

Under a Government Decree (120/2014), the General Government Fiscal Plan sets a budgetary objective for the whole of general government finances as well as separately for each sector of general government finances from 2015. This General Government Fiscal Plan presents the targets which the Government has set in its Government Programme and which it supplemented in the 2013 Stability Programme and also in the Structural Policy Programme it agreed in autumn 2013.

2.1 Medium-term budgetary objective (MTO)

A medium-term objective, which is revised at three-year intervals, must be set for the general government structural budgetary position. The spring 2013 Stability Programme set for Finland a medium-term objective of -0.5 per cent of GDP, which fulfils the minimum requirements set by both the Stability and Growth Pact and the national FIPO Act.

2.2 Budgetary targets of central government, local government, earnings-related pension funds and other social security funds

The Government Programme has set as an objective the balancing of central government finances by the end of this parliamentary term.

Government Programme did not specify an objective for the budgetary position of local government finances. In local government finances, a structural balance of revenue and expenditure is a natural goal. In the implementation of the Structural Policy Programme, the Government has committed to the implementation of measures aimed at balancing local government finances.

The funding of the earnings-related pension system, which belongs to the social security fund sector, is guided by a rule according to which the funding of the system is kept on a sustainable basis by increasing as required the insurance contributions levied on employers and those insured. The financing of other social security funds is based on a pay-as-you-go system in which the system's insurance contributions and transfers from other general government subsectors are determined such that annual revenue is sufficient to cover annual expenditure.

2.3 Targets for general government debt

The Government Programme set as an objective the achievement of a substantial reduction in the central government debt-to-GDP ratio by the end of this parliamentary term. If there are no indications of a fall in the central government debt-to-GDP ratio, the Government is committed to implementing the necessary adjustment measures directed at central government revenue and expenditure to achieve the targets.

2.4 Fiscal policy line

The state of and outlook for general government finances, national targets set by the Government, and commitments based on the coordination of the EU's economic policy define the framework in which fiscal policy is practiced.

The objective of the fiscal and economic policy of Prime Minister Jyrki Katainen's Government is to strengthen the financial foundation of the welfare society and conditions for growth to ensure that public finances are on a sustainable basis.

Through its fiscal and economic policy, the Government aims to close the public finances sustainability gap. A change in population age structure is reducing the number of people of working age and increasing age-related public expenditure. This weakens the budgetary position of general government finances. General government revenue is insufficient to cover general government expenditure within the anticipated normal development of the economy.

In its Government Programme, the Government committed to initiating the measures necessary to fully close the sustainability gap by 2015. On 29 August 2013, the Government decided on a Structural Policy Programme aimed at strengthening conditions for economic growth and bridging the sustainability gap in general government finances. Details of the programme were specified in November 2013 and March 2014.

The programme includes key elements for the reform of economic structures in a manner that supports economic growth and the sustainability of public finances: balancing local government finances, improving the productivity of public services provision with the aid of a structural reform of social and health care services and funding, and extending working careers through pension reform and other measures directed at the beginning of working careers and career breaks. Other measures outlined in the Structural Policy Programme, together with a labour market settlement that improves cost-competitiveness, will create an opportunity for faster than anticipated growth in the long term. The Government's earlier structural policy decisions, such as the lowering of the corporate income tax rate, the reform of the dividend taxation system, and measures to promote the employment of young people are in line with the objectives of the Structural Policy Programme.

Structural reforms that support economic growth and improve the productivity of public services provision are the key to sustainable fiscal management, because without reforms the anticipated economic growth will be insufficient to remove the sustainability gap. This will require the sure implementation of the Structural Policy Programme according to Government targets. The favourable impacts of the reforms on growth and on the sustainability of public finances will, however, only be realised as a rule in the long term.

The state of the Finnish economy has consistently proved to be weaker than expected and assessments of the medium-term outlook have deteriorated. Underlying the weak economic growth have been the problems of the global economy and the euro area, the restructuring of Finnish industry and weak competitiveness. As economic growth and employment have remained weaker than expected, achieving the targets set by the Government for central government finances has proved to be difficult.

The risk has grown that indebtedness will grow uncontrollably when the level of interest rates returns to normal. At the same time, the starting position for bridging the sustainability gap is more challenging. Strengthening conditions for growth with the aid of the Structural Policy Programme threatens to be too slow a route.

In this situation, it is important to maintain confidence in Finland's ability to manage its public finances and meet its obligations. Confidence creates room for manoeuvre to decide on the measures required to reduce indebtedness and ensure the sustainability of public finances. A reduction of central government deficits in a credible way is important to maintain confidence and to prevent an accelerating spiral of indebtedness in the medium term, before structural reforms have time to take full effect.

To ensure that central government indebtedness levels off in a credible way and within a realistic time frame, the Government has decided on new measures, which will reduce central government expenditure and increase revenue by EUR 2.3 billion at the 2018 level. The measures will be implemented mainly in 2015. The Government will submit to Parliament for decision the legislative changes required by the measures during the current parliamentary term. These measures will also be sufficient to fulfil the fiscal management obligations set by EU treaties.

In addition, the Government has decided on measures which, when implemented, would strengthen central government finances but whose effects cannot yet be taken into account at this stage in the central government spending limits nor in the macroeconomic forecast. These measures include measures that reduce local government expenditure whose implementation requires the stronger steering to be adopted in line with the social and health care service reform. The strengthening effect of these measures on central government finances is estimated at EUR 130 million at the 2017 level. In addition, those measures to improve structural unemployment whose effects can already be estimated may boost central government finances by EUR 230 million at the 2017 level.

During its term, the Government has adopted a range of measures with immediate impact to reduce central government expenditure and increase revenue, which will have a net impact at the 2018 level of around EUR 6.8 billion, i.e. around 3 per cent of GDP, compared with the last central government spending limits decision of the previous parliamentary term.

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