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## COVER NOTE

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From: Mr Samuli PIETILÄINEN, Financial Counsellor, Permanent Representation of Finland to the European Union

date of receipt: 9 October 2018

To: Mr Carsten PILLATH, Director General, Council of the European Union

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Subject: Finland:  
Draft Budgetary Plan of Finland as laid down in Article 6(1) of Regulation (EU) 473/2013 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

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Delegations will find attached Finland's Draft Budgetary Plan for 2019 in English.

This document is aimed for discussion in the Eurogroup.

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MINISTRY OF FINANCE

# 2019 Draft Budgetary Plan

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Economic Policy

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## 2018 Draft Budgetary Plan

Ministry of Finance, Helsinki 2018

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<b>Abstract</b>	<p>Under Regulation (EU) No 473/2013 of the European Parliament and of the Council (Regulation 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), euro area Member States are required to submit their draft budgetary plans (DBPs) for the forthcoming year to the Commission by 15 October. The DBPs are part of the coordinated surveillance exercise that takes place in the autumn. The DBP should allow the identification of any deviations from the general government finances strategy presented in the most recent Stability Programme. The DBP contains information on macroeconomic forecasts and assumptions, targets for general government finances, expenditure and revenue projections under the no-policy-change scenario, expenditure and revenue targets, discretionary measures included in the budget proposal, the goals of the European Union's strategy for growth and jobs and Country Specific Recommendations, a comparison between the DBP and the most recent Stability Programme, and an appendix on methods. Finland's 2019 Draft Budgetary Plan is based on the Government's budget proposal for 2019 submitted to Parliament on 17 September 2018, which for the most part is based on the spring 2018 spending limits decision, the 2018 supplementary budget and the 2019 programme for local government finances.</p>		
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***The 2019 Draft Budgetary Plan provides an assessment of the development of Finland's public finances in 2018 and 2019 as well as the Government's estimate of progress towards the Medium-Term Objective in accordance with Finland's Fiscal Policy Act (869/2012).***

### Compliance with the deficit and debt criteria

According to the independent forecast of the Ministry of Finance, the general government fiscal balance in ratio to GDP was -0.7% in 2017 and will be -0.7% in 2018, and -0.1% in 2019. Thus, Finland fulfils the deficit criterion of the Treaty on the Functioning of the European Union.

The debt ratio is now expected to develop more favourably than was estimated in spring 2018. According to the independent forecast of the Ministry of Finance, the general government debt ratio will fall below the reference value of 60% already in 2018 and continue to fall further in 2019.

The assessment of the Ministry of Finance is that the debt criterion of the Treaty on the Functioning of the European Union is fulfilled, as was already assessed this spring. Also the Commission did not produce a separate assessment of Finland's compliance with the debt criterion in spring 2018.<sup>1</sup> From 2018 onwards, the debt ratio will be below the 60% reference value. Thus, Finland fulfils the debt criterion of the Treaty.

### Compliance with the preventive arm of the Stability and Growth Pact

Finland is in the preventive arm of the Stability and Growth Pact (SGP) and is subject to the requirements of the preventive arm that relate to progress towards the Medium-Term Objective (MTO). The achievement of the MTO or progress towards it are assessed on the basis of two pillars – change in structural balance, and the expenditure benchmark.

<sup>1</sup> According to Finland's Stability Programme in spring 2018, Finland fulfilled the so-called forward-looking debt criterion in 2017 and the so-called backward-looking debt criterion in 2018. The Commission concurred with this assessment, and no report as per paragraph 3 of Article 126 of the Treaty on the Functioning of the European Union was produced in the case of Finland.

Finland's MTO for the structural balance is -0.5% in ratio to GDP and the Government is aiming to reach it no later than 2019. Finland reached the MTO already in 2016 and over-achieved it in 2017.

According to the Country-Specific Recommendations (CSRs) approved by the Council in July 2017, Finland should 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."<sup>2</sup>

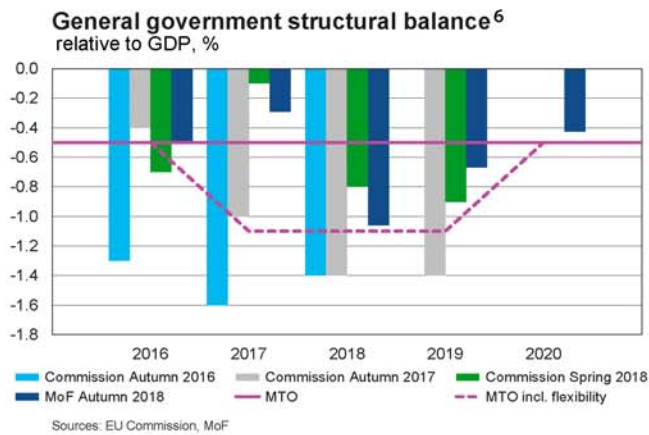
According to the independent forecast of the Ministry of Finance, the structural balance deteriorates in 2018. Firstly, this is due to the higher revenues in 2017, which were a consequence of one-off tax revenues, 0.4% of the GDP, but which, according to the Commission, were not one-off or temporary factors in the calculation of the structural deficit. Secondly, this is because of the unusually large tax rebates related to 2017 – based on preliminary data – which will be recorded for 2018. Therefore, the structural balance will deteriorate in 2018 more than was anticipated. However, the structural balance remains within the room of manoeuvre allowed by the flexibility granted to Finland on the basis of the structural reform and investment clauses, i.e. -1.1% of GDP.<sup>3</sup> The assessment by the Ministry of Finance is that Finland complies with the requirements concerning the structural balance in 2018 and cumulatively in 2017-2018. The assessment by the Ministry of Finance of the structural balance pillar aims to anticipate the ex-post assessment in spring 2019,<sup>4</sup> and may therefore deviate from the so-called in-year assessment by the European Commission in November 2018.<sup>5</sup> The differences are caused particularly by the changes in the different forecast rounds for the estimates of the structural balance, as shown in the figure below.

<sup>2</sup> In spring 2017, Finland was granted flexibility totalling 0.6% of GDP in accordance with the Stability and Growth Pact's structural reform and investment clauses based on implementation of reforms supporting the sustainability of public finances and co-financed EU investment projects. The flexibility was granted for three years, 2017-2019. The allowances linked to exceptional circumstances refer to the deviation related to the increased expenditure related to refugees in 2015-2016, which are taken into account in the Commission calculations.

<sup>3</sup> The assessment by the Ministry of Finance – to simplify – takes into account only the flexibilities requested by Finland, i.e. the structural reform clause and the investment clause. As regards the investment clause, the Commission estimated in spring 2018 based on preliminary data that public sector investment had fallen by 0.6% in 2017 and considered that the investment clause can no longer be applied in 2018-2019. However, the more up-to-date data of summer 2018 shows that public sector investments grew 3.3% in 2017. Thus, Finland fulfils the conditions of the investment clause and the investment clause has been taken into account in the Ministry of Finance assessment.

<sup>4</sup> Only an ex-post assessment, which for 2018 will be done in the spring 2019, can lead to opening of the so-called Significant Deviation Procedure (SDP).

<sup>5</sup> The Commission assessment in November 2018 will use requirements based on the so-called freezing principles, which means that the Commission will not take into account the improved starting position of 2017. Therefore, Commission November assessment may be that Finland is at risk of a significant deviation in 2018. As is stated in the Country-Specific Recommendations adopted in July 2018, the improved starting position in 2017 will, if confirmed, be taken into account in the ex-post assessments in spring 2019.



The assessment of the Ministry of Finance is that the expenditure benchmark will be complied with in 2018 and cumulatively in 2017–2018.

Thus, according to the assessment by the Ministry of Finance, the ex-post assessment in spring 2019 of compliance with the requirements of the preventive arm would arrive at the conclusion that Finland is in compliance with the recommendations given to it for the year 2018.

According to the Country-Specific Recommendations adopted by the Council in July 2018, Finland has to “ensure that the medium-term budgetary objective is achieved in 2019, taking into account the allowances linked to the implementation of structural reforms for which a temporary deviation is granted.”

According to the independent forecast of the Ministry of Finance, the structural balance is -0.7% of the GDP in 2019. Thus, according to the assessment of the Ministry of Finance, the structural balance is sufficiently close to the MTO, -0.5% of the GDP, and so the MTO can be deemed to have been achieved in the way planned by the Government.<sup>6</sup> The requirements concerning the structural balance are also met cumulatively.

The expenditure benchmark has a minor deviation both in 2019 and cumulatively in 2018–2019. However, this deviation is not significant.

<sup>6</sup> According to the Commission's so-called Vade Mecum publication, the MTO can be considered to have been achieved if the distance of the structural balance from the MTO does not exceed 0.25 % of GDP (Vade Mecum 2018, p. 36).

Thus, according to the assessment by the Ministry of Finance Finland will achieve its MTO and fulfil the requirements of the preventive arm in 2019 as well. In particular, it should be noted that Finland has adhered to the plan presented in the 2017 Draft Budgetary Plan when applying for the structural reform and investment clauses.

### **Government's assessment of progress towards the Medium Term Objective**

The Government agrees with the above assessment regarding progress towards the MTO. The MTO was achieved already in 2016 and it was adhered to in 2017. The MTO will continue to be adhered to in 2018 taking into account the flexibility granted to Finland. The MTO will be achieved in 2019 in the way planned by the Government.

Under section 3, subsection 1 of the Fiscal Policy Act (869/2012), the Government will initiate the measures it deems necessary to correct budgetary stability and sustainability if the structural balance of the general government, in the Government's assessment, deviates significantly in a manner that jeopardises the achievement of the MTO.

## 1. Macroeconomic forecasts<sup>1</sup>

**Table 0.i) Basic assumptions**

	2017	2018	2019
3-month Euribor	-0.3	-0.3	0.0
Long-term interest rate (10-year government bonds)	0.6	0.8	1.2
USD/€ exchange rate	1.2	1.2	1.1
Nominal effective exchange rate	0.3	3.8	0.2
World GDP growth (excl. The EU)	3.7	3.9	3.9
EU-27 GDP growth	2.4	2.3	2.0
Growth of relevant foreign markets	4.1	3.7	3.7
World trade growth	4.8	4.8	4.6
Oil prices (Brent, USD/barrel)	54.8	72.8	79.6

**Table 1a. Macroeconomic prospects**

	2017 level bn EUR	2017	2018	2019
		change, %		
1. Real GDP	196.787	2.8	3.0	1.7
Of which				
1.1. Attributable to the estimated impact of aggregated budgetary measures on economic growth				
2. Potential GDP	198.1	1.2	1.6	1.6
contributions:				
- labour				
- capital				
- total factor productivity				
3. Nominal GDP	223.8	3.6	4.6	3.5
Components of real GDP				
4. Private final consumption expenditure	121.9	1.3	2.1	1.6
5. Government final consumption	51.2	-0.5	0.6	0.5
6. Gross fixed capital formation	49.6	4.0	4.1	1.5
7. Changes in inventories and net acquisition of valuables (% of GDP)	1.0	0.4	0.6	0.6
8. Exports of goods and services	86.3	7.5	4.9	3.9
9. Imports of goods and services	85.4	3.5	3.5	3.0
Contributions to real GDP growth, % points				
10. Final domestic demand	222.7	1.5	2.2	1.3
11. Changes in inventories and net acquisition of valuables	1 001	-0.1	0.3	0.0
12. External balance of goods and services	0.8	1.4	0.6	0.3

<sup>1</sup> The Draft Budgetary Plan forecast, which was also the basis for the preparation of the Budget Proposal, has been prepared in the Economics Department of the Ministry of Finance. The forecast is independent and its formal independence is based on the so-called FIPO Act (Act on the Implementation of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (EMU), the implementation of Treaty provisions of a legislative nature as well as the amendment of the Act on requirements concerning multi-annual budgetary frameworks, 79/2015). The Draft Budgetary Plan is based on the information available on 30 August 2018 and, in addition, the Government's 2019 Budget Proposal, which was submitted to Parliament on 14 September 2018.

**Table 1b. Price developments**

	2017	2018	2019
	change, %		
1. GDP deflator	0.8	1.6	1.8
2. Private consumption deflator	1.1	1.2	1.5
3. HICP	0.8	1.1	1.4
4. Public consumption deflator	-0.1	1.8	2.6
5. Investment deflator	1.7	2.3	1.9
6. Export price deflator	3.1	2.4	1.9
7. Import price deflator	3.5	3.0	2.4

**Table 1c. Labour market developments**

	2017 level	2017	2018	2019
		change, %		
1. Employment, 1 000 persons	2 473	1.0	2.6	0.9
2. Employment, 1 000 000 hours worked	4 138	0.7	2.0	0.8
3. Unemployment rate (%)	234	8.6	7.4	6.9
4. Labour productivity, persons	79.6	1.8	0.4	0.7
5. Labour productivity, hours worked	47.6	2.1	1.0	0.9
6. Compensation of employees	104.9	0.7	3.4	2.8
7. Compensation per employee	42.4	-0.3	0.8	1.8

**Table 1d. Sectoral balances**

	2017	2018	2019
	% of GDP		
1. Net lending/borrowing vis-à-vis the rest of the world	0.7	0.5	0.7
of which:			
- Balance on goods and services	0.4	0.7	0.8
- Balance of primary incomes and transfers	0.3	-0.2	-0.2
- Capital account	0.0	-0.1	-0.1
2. Net lending/borrowing of the private sector	1.0	0.9	0.5
3. Net lending/borrowing of general government	-0.7	-0.7	-0.1
4. Statistical discrepancy	-0.3	-0.3	-0.3

## 2. Budgetary Targets

**Table 2a. General government budgetary targets broken down by subsector**

Net lending (+) / net borrowing (-) by subsector	2018	2019
	% of GDP	
1. General government	-0.7	-0.1
2. Central government	-1.5	-0.7
3. -		
4. Local government	-0.5	-0.3
5. Social security funds	1.3	1.0
6. Interest expenditure	0.9	0.8
7. Primary balance	0.2	0.7
8. One-off and other temporary measures	-0.1	0.1
9. Real GDP growth (%)	3.0	1.7
10. Potential GDP growth (%)	1.6	1.6
contributions:		
- labour		
- capital		
- total factor productivity		
11. Output gap	0.7	0.8
12. Cyclical budgetary component	0.4	0.5
13. Cyclically-adjusted balance	-1.1	-0.6
14. Cyclically-adjusted primary balance	-0.3	0.3
15. Structural balance	-1.1	-0.7

**Table 2b. General government debt developments**

	2018	2019
	% of GDP	
1. Gross debt	59.9	59.1
2. Change in gross debt ratio	-1.4	-0.9
Contributions to changes in gross debt		
3. Primary balance	-0.2	-0.7
4. Interest expenditure	0.9	0.8
5. Stock-flow adjustment	-2.1	-0.9
of which:		
- Differences between cash and accruals	0.1	0.2
- Net accumulation of financial assets	0.5	0.6
of which:		
- privatisation proceeds	-0.4	-0.2
- Valuation effects and other	-2.6	-1.7
p.m.: Implicit interest rate on debt	1.5	1.4
Other relevant variables		
6. Liquid financial assets		
7. Net financial debt		
8. Debt amortization (existing bonds) since the end of the previous year		
9. Percentage of debt denominated in foreign currency		
10. Average maturity		



### 3. Expenditure and Revenue Projections under the no-policy change scenario

**Table 3. General government expenditure and revenue projections at unchanged policies broken down by main components**

General government	2018	2019
	% of GDP	
1. Total revenue at unchanged policies	51.9	51.8
Of which		
1.1. Taxes on production and imports	13.9	13.8
1.2. Current taxes on income, wealth, etc.	16.0	16.4
1.3. Capital taxes	0.3	0.3
1.4. Social contributions	12.0	11.7
1.5. Property income	2.9	2.9
1.6. Other	6.8	6.7
p.m.: Tax burden	42.3	42.2
2. Total expenditure at unchanged policies	52.6	51.8
Of which		
2.1. Compensation of employees	12.1	11.9
2.2. Intermediate consumption	10.5	10.6
2.3. Social payments	21.3	21.1
of which Unemployment benefits	2.1	1.9
2.4. Interest expenditure	0.9	0.8
2.5. Subsidies	1.2	1.1
2.6. Gross fixed capital formation	4.0	3.8
2.7. Capital transfers	0.3	0.2
2.8. Other	2.3	2.3

## 4. Expenditure and Revenue targets

**Table 4a. General government expenditure and revenue targets, broken down by main components**

General government	2018	2019
	% of GDP	
1. Total revenue target	51.9	51.8
Of which		
1.1. Taxes on production and imports	13.9	13.8
1.2. Current taxes on income, wealth, etc.	16.0	16.3
1.3. Capital taxes	0.3	0.3
1.4. Social contributions	12.0	11.7
1.5. Property income	2.9	2.9
1.6. Other	6.8	6.7
p.m.: Tax burden	42.3	42.2
2. Total expenditure target	52.6	51.9
Of which		
2.1. Compensation of employees	12.1	11.9
2.2. Intermediate consumption	10.5	10.5
2.3. Social payments	21.3	21.1
of which Unemployment benefits	2.1	1.9
2.4. Interest expenditure	0.9	0.8
2.5. Subsidies	1.2	1.1
2.6. Gross fixed capital formation	4.0	3.8
2.7. Capital transfers	0.3	0.2
2.8. Other	2.3	2.3

**Table 4b. Amounts to be excluded from the expenditure benchmark**

	2017 EUR million	2017	2018	2019
		% of GDP		
1. Expenditure on EU programmes fully matched by EU funds revenue	450	0.2	0.2	0.2
1.a of which investments	127	0,1	0,1	0,1
2. Cyclical unemployment benefit expenditure	950	0.4	0.2	0.1
3. Effect of discretionary revenue measures	-1684	-0.8	-0.4	-0.3
4. Revenue increases mandated by law	80	0.0	0.0	0.0

## 5. Description of discretionary measures included in the draft budget

**Table 5a. Discretionary measures taken by General Government**

List of measures	Detailed description	Target	Accounting principle	Adoption in status	Budgetary impact		
					2018	2019	2020
					of GDP %		
Personal income tax	Personal income tax		accrual	partly decided**	-0.2	-0.1	-0.2
Corporate income tax	Corporate income tax		accrual	partly decided**	0.0	0.0	0.0
Indirect taxes	Indirect taxes		accrual	partly decided**	0.0	0.1	0.0
Contributions	Contributions		accrual	proposal***	-0.2	-0.3	0.2
Expenditure measures, total	Expenditure measures, total		accrual, cash-based	partly decided**	-0.3	-0.3	-0.1

\* Many of the discretionary measures do not pass a size criterion (at least 0,05% of the GDP). Therefore the measures are combined and merely the aggregate effect of measures is reported. Some of the measures are temporary but most of them are permanent.

\*\*Parliament will confirm during fall 2018

\*\*\*Ministry of Social Affairs and Health will confirm during fall 2018

**Table 5b. Discretionary measures taken by Central Government**

List of measures	Detailed description	Target	Accounting principle	Adoption in status	Budgetary impact		
					2018	2019	2020
					of GDP %		
Personal income tax	Personal income tax		accrual	partly decided**	-0.2	-0.1	-0.2
Corporate income tax	Corporate income tax		accrual	partly decided**	0.0	0.0	0.0
Indirect taxes	Indirect taxes		accrual	partly decided**	0.0	0.1	0.0
Expenditure measures, total	Expenditure measures, total		accrual, cash-based	partly decided**	-0.3	-0.3	-0.1

\* Many of the discretionary measures do not pass a size criterion (at least 0,05% of the GDP). Therefore the measures are combined and merely the aggregate effect of measures is reported. Some of the measures are temporary but most of them are permanent.

\*\*Parliament will confirm during fall 2018

## 6. Indications on how measures of the Draft Budgetary Plan address Country-Specific Recommendations (CSR) and the targets set by the Union's Strategy for Growth and Jobs

**Table 6a: Country-Specific Recommendations**

CSR number	Measures	Description of direct relevance
Country-specific recommendation 1: Achieve the medium-term budgetary objective in 2019, taking into account the allowances linked to the implementation of the structural reforms for which a temporary deviation is granted. Ensure the adoption and implementation of the administrative reform to improve cost-effectiveness and equal access to social and healthcare services;	SOTE (i.e. social and healthcare reform) and Regional Reform are intended to be decided upon in Parliament in the autumn of 2018. The aim is for these reforms to come into effect as of the beginning of January 2021.	The measures respond directly to the recommendation concerning the administrative reform of the social and healthcare services.
Country-specific recommendation 2: To improve incentives to accept work and ensure adequate and well-integrated services for the unemployed and the inactive;	<p>The draft budget of the Government embodies a decision to increasing the use of and facilitation of the use of wage subsidies in companies so that long-term unemployed persons and those partially able to work would be more likely to find jobs. Concrete actions:</p> <ul style="list-style-type: none"> <li>- Companies to be paid employment reward when a set-term employment relationship becomes an employment relationship for the present or if a company employs an unemployed person with wage subsidy support for a position of employment for the present.</li> <li>- Job centres to start applying performance rewards to promote job finding for long-term unemployed persons</li> <li>- To promote the acceptance of short-term work in the allocation of unemployment benefits there will be a switch away from the current earnings-based allocation to allocation based on point-in-time of payment.</li> </ul> <p>Furthermore, a nationwide work-ability programme will be established with the purpose of developing the individual identification of the ability to work and ability to function among long-term unemployed persons as well as identifying their rehabilitation needs.</p>	The measures respond directly to the recommendation.
Country-specific recommendation 3; Strengthen the monitoring of household debt including by setting up a credit registry system.	<p>The Ministry of Justice has commissioned a report proposing the establishment of a centralized positive credit registry. The proposal is circulated for comments after which the matter will be further assessed.</p> <p>In 2018, a three-year pilot project on preventing financial problems of tenants was launched. The project organizes housing and financial counseling, payments programs, microfinance and rehabilitation into a coherent and flexible customer service.</p>	The measures respond directly to the recommendation.

**Table 6b: Targets set by the Union's Strategy for Growth and Jobs**

No significant changes after spring 2018

See: <https://ec.europa.eu/info/sites/info/files/2018-european-semester-national-reform-programme-finland-en.pdf>

## 7. Divergence from latest SP

**Table 7. Divergence from latest SP**

	2017	2018	2019
	% GDP		
Target general government net lending/net borrowing			
Stability Programme	-0.6	-0.6	-0.2
Draft Budgetary Plan	-0.7	-0.7	-0.1
Difference	-0.1	-0.1	0.1
General government net lending projection at unchanged policies			
Stability Programme	-0.6	-0.6	-0.2
Draft Budgetary Plan	-0.7	-0.7	0.0
Difference	-0.1	-0.1	0.2

The income distribution effects of the budget proposal has been estimated in a separate memorandum:

<https://vm.fi/documents/10623/6305483/Talousarvioesityksen+tulonjako+B0/c325cc2b-ccbe-4f73-90da-833f7ca1c2d5/Talousarvioesityksen+tulonjako+B0.pdf>

**Table 8. Comparison with the Commission's previous forecast**

	Commission. May 2018			Mof. September 2018		
	2017	2018	2019	2017	2018	2019
GDP. change. %	2.6	2.5	2.3	2.8	3.0	1.7
unemployment rate. %	8.6	8.4	8.3	8.6	7.4	6.9
General government fiscal balance. % of GDP	-0.6	-0.7	-0.2	-0.7	-0.7	-0.1
Structural balance. % of GDP	-0.1	-0.8	-0.9	-0.3	-1.1	-0.7
General government gross debt. % of GDP	61.4	60.4	59.6	61.3	59.9	59.1

## APPENDIX 1

The macro forecast is based on the views of experts, the Ministry of Finance DSGE model (see e.g. Economic Survey, autumn 2017, p. 17), a short-term factor model and various partial models.

The forecast for general government finances is based on, among other things, a shortterm macro forecast and medium-term calculations as well as budget proposals, spending limits decisions, tax base forecasts and discretionary tax changes as well as detailed tax revenue estimates derived from them, the programme for local government finances and decisions on social security contributions and benefits.



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