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COVER NOTE

From: Secretary-General of the European Commission,
signed by Mr Jordi AYET PUIGARNAU, Director

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To: Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of
the European Union

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National Reform Programme of Finland and delivering a Council opinion on
the 2019 Stability Programme of Finland

Delegations will find attached document COM(2019) 526 final.

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Recommendation for a

COUNCIL RECOMMENDATION

**on the 2019 National Reform Programme of Finland and delivering a Council opinion
on the 2019 Stability Programme of Finland**

Recommendation for a

COUNCIL RECOMMENDATION

on the 2019 National Reform Programme of Finland and delivering a Council opinion on the 2019 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 policies¹, and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it did not identify Finland as one of the Member States for which an in-depth review would be carried

¹ OJ L 209, 2.8.1997, p. 1.

out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 21 March 2019. On 9 April 2019, the Council adopted the recommendation on the economic policy of the euro area ('Recommendation for the euro area').

- (2) As a Member State 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, as reflected in recommendations (3) and (4) below. In particular, focusing economic policy related to investment in the specified areas will help address the second euro area recommendation as regards supporting investment, and measures to contain household indebtedness will help address the fourth euro area recommendation as regards reducing private debt.
- (3) The 2019 country report for Finland² was published on 27 February 2019. It assessed Finland's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018, the follow-up given to the recommendations adopted in previous years and Finland's progress towards its national Europe 2020 targets.
- (4) On 4 April 2019, Finland submitted its 2019 National Reform Programme and its 2019 Stability Programme. To take account of their interlinkages, the two programmes have been assessed at the same time.
- (5) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds ('ESI Funds') for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council³, where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance⁴.
- (6) Finland is currently in the preventive arm of the Stability and Growth Pact. In its 2019 Stability Programme, which was submitted on a no-policy-change basis by the previous government shortly before the general elections in April, the government plans a headline balance of -0.3% of GDP in 2019, down from 0.7% of GDP from 2018. According to the Government, the balance is projected to improve further in 2020 to 0% and, thereafter, to worsen again to -0.1% in 2021 and -0.3% in 2022. Based on the recalculated structural balance⁵, the medium-term budgetary objective, set at a

² SWD(2019) 1025 final.

³ 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).

⁴ COM(2014) 494 final.

⁵ Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

structural deficit of 0.5% of GDP, is planned to continue to be overachieved throughout the programme period, taking account of the allowances in 2019 linked to the implementation of the structural reforms for which a temporary deviation is granted. The general government debt-to-GDP ratio, which peaked at 63.4% in 2015, declined to 58.9% in 2018. According to the 2019 Stability Programme, the debt ratio will continue to decrease and reach 57.4% of GDP in 2021. It is projected to increase again in 2022 to 57.7% of GDP. The macroeconomic scenario underpinning those budgetary projections appears to be broadly plausible. The main risks to the budgetary projections relate to the possible larger-than-expected cost of ageing and higher inflation.

- (7) On 13 July 2018, the Council recommended Finland to achieve the medium-term budgetary objective in 2019, taking account of the allowances linked to the implementation of the structural reforms for which a temporary deviation is granted. This is consistent with a maximum nominal growth rate of net primary government expenditure⁶ of 2.9% in 2019, corresponding to an allowed deterioration in the structural balance by 0.2% of GDP. According to the Commission 2019 spring forecast, Finland is expected to be at its medium-term budgetary objective in 2019 taking account of the granted allowance linked to the structural reform clause.
- (8) In 2020, in view of Finland's projected output gap of 0.8%, the nominal growth rate of net primary government expenditure should not exceed 1.9%, in line with the structural adjustment of 0.5% of GDP stemming from the commonly agreed adjustment matrix of requirements under the Stability and Growth Pact. According to the Commission 2019 spring forecast under unchanged policies, Finland is projected to be at risk of some deviation in 2020. Overall, the Council is of the opinion that Finland is projected to comply with the provisions of the Stability and Growth Pact in 2019 and needs to stand ready to take further measures to ensure compliance with the provisions of the Stability and Growth Pact in 2020.
- (9) Due to the ageing population and declining workforce, spending on pensions, health and – especially – social care (long-term care) is projected to increase in the coming decades. According to the 2018 Fiscal Sustainability Report, the projected increase in ageing costs would require a fiscal consolidation amounting to 2% of GDP to stabilise the debt-to-GDP ratio in the long term. A reform of regional government, health and social services, designed to address these challenges and to ensure equal access and reduce waiting times, was rejected by the Finnish Parliament on 7 March 2019. The ratio of self-declared unmet medical needs in Finland remains above the EU average. In particular, people outside the workforce are having difficulties getting the necessary medical care due to long waiting lists.
- (10) Amid a shrinking working-age population and rising levels of vacancies, the Finnish labour market is tightening. At the same time, activity and employment rates in Finland are lower than in the other Nordic countries and structural unemployment

⁶ Net primary government expenditure comprises 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 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.

remains at 7% in 2018. This partly reflects inactivity and unemployment traps hindering a better use of the labour force. The main barriers to getting people back to work include the complex benefits system and the combination of different types of allowances. Benefits are phased out rapidly as income increases, which creates the risk that taking up work might not be sufficiently financially rewarding. Uncertainty surrounding the level of benefits and the time to reinstate them reduces the attractiveness of short-term or part-time work. The basic income experiment, the preliminary results of which were published in February 2019, provides some information for revising the social security system to combine benefits more effectively with earnings.

- (11) Investments in active inclusion, especially of groups furthest from the labour market, are necessary to increase the participation rate now that activity and employment rates are close to pre-crisis levels. Comprehensive reforms aiming at fostering labour market participation could bring about better opportunities in the labour market for some groups. This concerns people with a migrant background, women at childbearing age, low-skilled men, people partially able to work and persons with disabilities. Some services for the unemployed and inactive are dispersed among separate authorities and providers. Helping these groups to join and remain in the labour market requires tailor-made and integrated activation and rehabilitation services and policies. Long caretaking responsibilities for women contribute to the gender employment gap and the gender pay gap. The government initiated a process to reform family leave, but did not carry it through.
- (12) Ensuring the supply of labour in times of demographic and technological change is key to fostering sustainable and inclusive growth in Finland. Investing in skills, especially those relevant to the labour market, would help meet the challenges created by structural change in the economy. Technological change calls for continuous training and reskilling of the workforce through flexible ways of learning, including by focusing on adult learning, education and training. This should increase occupational mobility, reducing skills mismatches and helping to meet future labour market needs.
- (13) Finland is at risk of missing the 2020 municipal waste recycling target of 50%. In particular, municipal waste is increasingly incinerated (60% in 2017 compared to 55% in 2016).
- (14) While public spending on research and development is now stabilising, Finland experienced the sharpest decline of all EU Member States since 2009 in private-sector investment in research and development. Despite an improvement in the macro-economic situation in recent years, private-sector investment in research and development has not recovered yet. A higher intensity of investment in research and development is a key factor enabling structural change to favour knowledge-intensive sectors of the economy and strengthen long-term growth potential. In addition, cooperation between higher education institutions and the business sector remains one of the key bottlenecks to stimulating innovations and bringing them to the market.
- (15) With a dispersed population, transport bottlenecks may prevent people from moving to find jobs. Strategic investment in the transport infrastructure may improve labour mobility and thereby strengthen the functioning of labour markets. In parallel, as transport costs have a relatively high impact on the final price of products in Finland

compared to other EU Member States, infrastructure interconnections could enhance access to markets abroad.

- (16) Strategic investment in decarbonising energy-intensive industries and the transport sector would help achieve long-term economic and climate goals. Finland is a leader in clean energy innovation and private research and development spending in this area. Further investment in some of its clean energy programmes by 2021, as committed, would help Finland meet its carbon neutrality objectives. Besides Finland's ambitious objectives for increasing the share of biofuels, electrification is a cost-efficient option for decarbonising the transport sector, given the advanced decarbonisation of power generation.
- (17) Low interest rates and the improved economic outlook have increased the overall volume of lending, especially through housing corporations (which provide a distinctive form of home ownership). In parallel, consumer credit is increasing rapidly and a rising share of this lending is granted by foreign banks, financial institutions other than credit institutions, small-loan companies and peer-to-peer lending. Household debt therefore remains at a historically high level (67% of GDP in 2017). The debt is predominantly at a variable rate, which constitutes a risk if interest rates rise in the medium term. The Finnish Financial Supervisory Authority has adopted a number of measures to contain the increase in the indebtedness of households. However, no active reduction of the debt burden is expected soon, especially as interest rates remain low and consumer confidence is still relatively strong.
- (18) At this stage, Finland does not have a comprehensive (i.e. collecting both positive and negative information on debtors) credit registry that covers its major banks. The lack of this can prevent banks having a clear overview of households' overall indebtedness. Some preparatory work for the setting up of a registry of this kind has been carried out in the last year.
- (19) The programming of EU funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the country report⁷. This would allow Finland to make the best use of those funds in respect of the identified sectors, taking into account regional disparities.
- (20) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Finland's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme and the 2019 National Reform Programme and the follow-up given to the recommendations addressed to Finland in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Finland, but also their compliance with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.
- (21) In the light of this assessment, the Council has examined the 2019 Stability Programme and its opinion⁸ is reflected in particular in recommendation (1) below.

⁷ SWD(2019) 1025 final.

⁸ Under Article 5(2) of Council Regulation (EC) No 1466/97.

- (22) In the light of this assessment, the Council has examined the 2019 National Reform Programme and the 2019 Stability Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (4) below.

HEREBY RECOMMENDS that Finland take action in 2019 and 2020 to:

1. Ensure that the nominal growth rate of net primary government expenditure does not exceed 1.9% in 2020, corresponding to an annual structural adjustment of 0.5% of GDP. Improve the cost-effectiveness of and equal access to social and healthcare services.
2. Improve incentives to accept work and enhance skills and active inclusion, notably through well-integrated services for the unemployed and the inactive.
3. Focus investment-related economic policy on research and innovation, low carbon and energy transition and sustainable transport, taking into account regional disparities.
4. Strengthen the monitoring of household debt and establish the credit registry system.

Done at Brussels,

*For the Council
The President*