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Recommendation for a

COUNCIL RECOMMENDATION

with a view to bringing an end to the situation of an excessive government deficit in Finland

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 126(7) thereof;

Having regard to the recommendation from the European Commission;

Whereas:

(1) According to Article 126 of the Treaty Member States shall avoid excessive government deficits.

(2) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.

(3) The 2005 reform of the Stability and Growth Pact sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run. It aimed at ensuring that in particular the economic and budgetary background was taken into account fully in all steps in the EDP. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation.

(4) The Council has decided on [13 July 2010], in accordance with Article 126(6) of the treaty, that an excessive deficit exists in Finland.

(5) In accordance with Article 126(7) of the Treaty and Article 3 of Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure[1] (which is part of the Stability and Growth Pact), the Council is also required to make recommendations to the Member State concerned with a view to bringing the situation of excessive deficit to an end within a given period. The recommendation has to establish a deadline of six months at the most for effective action to be taken by the Member State concerned to correct the excessive deficit as well as a deadline for the correction of the excessive deficit, which should be completed in the year following its identification unless there are special circumstances. In deciding whether special circumstances exist, “relevant factors” as clarified in Article 2(3) of Regulation (EC) No 1467/97 should be taken into account.

[1] OJ L 209, 2.8.1997, p. 6.

Furthermore, in a recommendation to correct an excessive deficit the Council should request the achievement of a minimum annual improvement in the structural balance, i.e. the cyclically-adjusted balance excluding one-off and other temporary measures, of 0.5% of GDP as a benchmark.

(6) In the case of Finland, the relevant factors, as clarified in Article 2(3) of Regulation (EC) No 1467/97 and examined in the Commission's report under Article 124(3), were considered favourable. However, they do not suggest the existence of special circumstances warranting a departure from the standard deadline for correcting the deficit. In particular, according to the Commission services' spring 2010 forecast, the general government deficit would fall by a narrow margin below the 3% reference value under a no-policy-change assumption already in 2011.

(7) Prior to the global crisis, Finland built up a substantial surplus in public finances. This has allowed Finland provide for a relatively large discretionary fiscal stimulus amounting to 1.8% of GDP in 2009 and 1.1% in 2010 and to allow a full operation of automatic stabilisers. This has turned the general government finances into a deficit of 2.2% of GDP in 2009. The deficit is projected to widen further to 4.1% of GDP in 2010 according to the April 2010 EDP notification presented by the Ministry of Finance. The Commission service's spring forecast projected a slightly smaller deficit of 3.8% of GDP in 2010. The third supplementary budget presented by the Ministry of Finance to the Parliament on 14 May 2010 suggests that tax revenue in 2010 could turn out by 0.5% of GDP higher-than-planned, principally on account of stronger corporate income tax accrual. This indicates upside risks to the current public finance projections, but given that no full-fledged update of these projections has been made, the deficit target for 2010 has not been officially changed and the current assessment remains valid. In 2011, both the Ministry of Finance and the Commission services' forecast the general government deficit to fall narrowly below 3% of GDP on a no policy change assumption. On the basis of the Commission services' forecast, the correction of the excessive deficit in 2011 implies a fiscal effort of around 0.3 percentage points of GDP in 2011.

(8) The main tool in controlling central government expenditure are the multiannual spending limits, which exclude cyclically sensitive expenditure items and have therefore allowed the full operation of automatic stabilisers. While this setup, in particular the free operation of automatic stabilisers, has supported economic activity and social cohesion over the crisis period, it has also led to a relatively sharp negative swing in public finances. This budgetary framework will therefore effectively support the reduction of central government expenditure pressures, including social expenditure, only once the economic recovery is well underway. Local governments are responsible for a large part of age-related public expenditure such as education, health and long-term care and they are not bound by centrally-imposed expenditure limits. To compensate for increasing expenditure, local tax rates have typically been increased, avoiding building up debt at the municipal level but adding to the overall national tax burden. The government pursues reforming local governments' structures and service provision in the medium term with the aim of curbing expenditure growth related to population ageing.

(9) In its opinion of 26 April 2010 on the most recent stability programme update, the Council assessed the long-term sustainability of Finland's public finances and invited the authorities to take timely action to define a comprehensive and concrete medium

term fiscal strategy to consolidate from 2011 onwards, also with a view to achieve the MTO and to restore the long-term sustainability of public finances.

(10) The general government gross debt amounted to 44% of GDP in 2009. The April EDP notification expects the debt ratio to rise to 49.9% of GDP in 2010. The Commission spring forecast projected the debt ratio to grow slightly faster, reaching 50.5% of GDP in 2010 and 54.9% of GDP in 2011, still remaining below the 60% of GDP reference value.

(11) Enhanced surveillance under the EDP will require regular and timely monitoring of the progress made in the implementation of the fiscal consolidation strategy. In this context, a separate chapter in the forthcoming updates of the Finnish stability programme could usefully be devoted to this issue.

(12) In general, in the view of the Council, budgetary consolidation measures should secure a lasting improvement in the general government balance, while being geared towards enhancing the quality of the public finances and reinforcing the growth potential of the economy.

HAS ADOPTED THIS RECOMMENDATION:

(1) Recognising that Finland’s budgetary position in 2010 resulted from measures amounting to 1.8% of GDP in 2009 and 1.1% in 2010, which is an adequate response to the downturn and were in line with the European Economic Recovery Plan principles, as well as from the free play of automatic stabilisers, the Finnish authorities should put an end to the present excessive deficit situation at the latest by 2011.

(2) The Finnish authorities should bring the general government deficit below 3% of GDP in a credible and sustainable manner. Specifically, to this end, the Finnish authorities should:

(a) implement the fiscal measures in 2010 as envisaged in the latest update of the stability programme, while ensuring that the planned breach of the 3%-of-GDP reference value would remain contained and temporary;

(b) ensure a fiscal effort of at least ½% of GDP in 2011;

(c) specify measures to ensure that the planned correction of the excessive deficit in 2011 is secured.

(3) The Council establishes the deadline of [13 January 2011] for the Finnish government to take effective action to specify the measures that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared with the economic outlook in the Commission services' spring 2010 forecast.

The Finnish authorities should report on progress made in the implementation of these recommendations in a separate chapter in the forthcoming updates of the stability programme until the abrogation of the excessive deficit procedure.

In addition, the Council highlights the importance of achieving the medium-term objective (MTO) for appropriate budgetary management of economic downturns and also with a view of restoring the long-term sustainability of public finances. It therefore invites the Finnish authorities to ensure that budgetary consolidation towards the medium-term objective for the budgetary position –a structural surplus of 0.5% of GDP – is sustained after the excessive deficit will have been corrected.

This recommendation is addressed to the Republic of Finland.

Done at Brussels,

For the Council
The President