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*(Resolutions, recommendations, guidelines and opinions)*

# OPINIONS

# COUNCIL

## COUNCIL OPINION

**of 27 February 2007**

**on the updated stability programme of Finland, 2006-2010**

(2007/C 71/01)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

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(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On 27 February 2007 the Council examined the updated stability programme of Finland, which covers the period 2006 to 2010.

(2) The macroeconomic scenario underlying the programme envisages that real GDP growth will decelerate from a cyclical peak of 4 ½ % in 2006 to 2 ½ % on average over the rest of the programme period. Assessed against currently available information, this scenario appears to be based on plausible growth assumptions, with those for 2006 and 2010 appearing cautious. The programme's projections for inflation appear realistic.

(3) For 2006, the general government surplus is estimated at 2,9 % of GDP in both the Commission services' autumn 2006 forecast and in the current programme update, against a target of 1,6 % of GDP set in the previous update of the stability programme. This is due to the carry-over from the better-than-expected outcome in 2005 and the positive growth surprise in 2006 boosting government revenue, while expenditure has remained contained.

([1]) OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). The documents referred to in this text can be found at the following website:
http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm

(4) The main goal of the medium-term budgetary strategy in the programme is securing sustainability in general government finances and balanced central government finances under normal conditions of economic growth. The general government headline and primary surpluses are projected to follow a slight downward trend, both declining by ½ % of GDP until 2010. The decline in the revenue ratio, reflecting the gradual phasing in of the tax cuts package up to 2007, is less than fully compensated by the cut in the expenditure ratio owing to the government's budgetary spending ceilings and public sector reform initiatives. While the budgetary strategy has not changed compared with the previous update, the budgetary targets have been revised up by about 1 % of GDP in each year, as a result of the carry-over from the better-than-expected outcome in 2005 and higher growth prospects.

(5) The structural balance (i.e. the cyclically-adjusted balance net of one-off and other temporary measures) calculated according to the commonly agreed methodology is planned to remain stable at a surplus of close to 3 % of GDP throughout the programme period. The medium-term objective (MTO) for the budgetary position presented in the programme is a structural surplus of 2 % of GDP, which it plans to maintain throughout the programme period. The previous programme update did not explicitly define an MTO, but the MTO was inferred in the Council opinion from the structural surplus projections in the previous programme to be a surplus of 1½ % of GDP. As the MTO is more demanding than the minimum benchmark (estimated at a deficit of around 1¼ % of GDP), achieving it should fulfil the aim of providing a safety margin against the occurrence of an excessive deficit. The MTO lies within the range indicated for euro-area and ERM II Member States in the Stability and Growth Pact and the code of conduct and is significantly more demanding than implied by the debt ratio and average potential output growth in the long term. Having an MTO well above the minimum required level is motivated in the programme by the goal of ensuring the long-term sustainability of public finances and the fact that in Finland the impact of an ageing population kicks in at an early stage.

(6) The risks to the budgetary projections in the programme appear broadly balanced. The programme's macroeconomic assumptions as well as the tax revenue projections appear plausible. The risks to the latter emanating from the composition of growth are counterbalanced by conservative tax elasticity assumptions. Deviations from the projected growth path could have a strong impact on the fiscal outcome. In addition, notable risks are considered to be related to developments in local government expenditure.

(7) In view of this risk assessment, the budgetary stance in the programme seems sufficient to meet the MTO by a considerable margin throughout the programme period, as envisaged in the programme. In addition, it provides a sufficient safety margin against breaching the 3 % of GDP deficit threshold with normal macroeconomic fluctuations over the programme period. The fiscal policy stance implied by the programme is fully in line with the Stability and Growth Pact.

(8) Government gross debt is estimated to have declined to 39 % of GDP in 2006, well below the 60 % of GDP Treaty reference value. The programme projects the debt ratio to decline by 5 ½ percentage points over the programme period.

(9) The long-term budgetary impact of ageing in Finland is higher than on average in the EU, although enacted pension reform measures have helped to contain the increase in pension expenditure to close to the EU average as a share of GDP over the coming decades. The initial budgetary position, with a large structural surplus, contributes significantly to easing the long-term budgetary impact of ageing. Moreover, the large assets accumulated in the public pension fund will finance part of the increase in pension expenditure. However, maintaining high primary surpluses over the medium term would contribute towards containing risks to the sustainability of public finances. Overall, Finland appears to be at low risk with regard to the sustainability of public finances.

(10) The stability programme contains a qualitative assessment of the overall impact of the October 2006 implementation report of the national reform programme within the medium-term fiscal strategy. In addition, it provides systematic information on the direct budgetary costs or savings of the main reforms envisaged in the national reform programme and its budgetary projections explicitly take into account the public finance implications of the actions outlined in the national reform programme. The measures in the area of public finances envisaged in the stability programme seem consistent with those foreseen in the national reform programme. In particular, both programmes envisage the implementation of measures to improve the productivity of both central and local governments and confirm the intention to continue applying central government budgetary spending limits beyond the current legislative period.

(11) The budgetary strategy in the programme is broadly consistent with the broad economic policy guidelines included in the integrated guidelines for the period 2005-2008.

(12) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme has some gaps in the required and optional data ([1]).

The Council considers that the medium-term budgetary position is sound and the budgetary strategy provides a good example of fiscal policies conducted in compliance with the Stability and Growth Pact. Nevertheless, expenditure restraint will remain crucial in the coming years when the forecast cooling of the economy slows growth in the tax bases and the impact of ageing population kicks in.

**Comparison of key macroeconomic and budgetary projections**

| | | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|
| Real GDP (% change) | **SP Nov 2006** | **2,9** | **4,5** | **3,0** | **2,9** | **2,6** | **2,1** |
| | COM Nov 2006 | 2,9 | 4,9 | 3,0 | 2,6 | n.a. | n.a. |
| | *SP Nov 2005* | *2,1* | *3,2* | *2,6* | *2,3* | *2,1* | *n.a.* |
| HICP inflation (%) | **SP Nov 2006** | **0,9** | **1,5** | **1,3** | **1,7** | **1,7** | **1,7** |
| | COM Nov 2006 | 0,8 | 1,3 | 1,5 | 1,6 | n.a. | n.a. |
| | *SP Nov 2005* | *1,0* | *1,3* | *1,5* | *1,8* | *1,8* | *n.a.* |
| Output gap (% of potential GDP) | **SP Nov 2006** ([1]) | **– 1,3** | **0,1** | **0,2** | **0,1** | **– 0,2** | **– 0,8** |
| | COM Nov 2006 ([5]) | – 1,5 | 0,1 | 0,2 | – 0,2 | n.a. | n.a. |
| | *SP Nov 2005* ([1]) | *– 0,7* | *– 0,2* | *– 0,2* | *– 0,5* | *– 0,9* | *n.a.* |
| General government balance (% of GDP) | **SP Nov 2006** | **2,7** | **2,9** | **2,8** | **2,7** | **2,7** | **2,4** |
| | COM Nov 2006 | 2,7 | 2,9 | 2,9 | 2,9 | n.a. | n.a. |
| | *SP Nov 2005* | *1,8* | *1,6* | *1,6* | *1,5* | *1,5* | *n.a.* |

([1]) In particular, the data on external assumptions for the years 2008-2010 are missing.

| | | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|
| Primary balance (% of GDP) | **SP Nov 2006** | **3,9** | **4,5** | **4,3** | **4,2** | **4,1** | **3,7** |
| | COM Nov 2006 | 4,1 | 4,3 | 4,2 | 4,1 | n.a. | n.a. |
| | *SP Nov 2005* | *3,4* | *3,1* | *2,9* | *2,8* | *2,8* | *n.a.* |
| Cyclically-adjusted balance (% of GDP) | **SP Nov 2006** (1) | **3,3** | **2,9** | **2,7** | **2,7** | **2,8** | **2,8** |
| | COM Nov 2006 | 3,4 | 2,9 | 2,8 | 2,9 | n.a. | n.a. |
| | *SP Nov 2005* (1) | *2,1* | *1,7* | *1,7* | *1,7* | *2,0* | *n.a.* |
| Structural balance (2) (% of GDP) | **SP Nov 2006** (3) | **3,3** | **2,9** | **2,7** | **2,7** | **2,8** | **2,8** |
| | COM Nov 2006 (4) | 3,4 | 2,9 | 2,8 | 2,9 | n.a. | n.a. |
| | *SP Nov 2005* | *2,1* | *1,7* | *1,7* | *1,7* | *2,0* | *n.a.* |
| Government gross debt (% of GDP) | **SP Nov 2006** | **41,3** | **39,1** | **37,7** | **36,2** | **35,0** | **33,7** |
| | COM Nov 2006 | 41,3 | 38,8 | 37,3 | 35,8 | n.a. | n.a. |
| | *SP Nov 2005* | *42,7* | *41,7* | *41,1* | *40,6* | *40,1* | *n.a.* |

Notes:

(1) Commission services calculations on the basis of the information in the programme.
(2) Cyclically-adjusted balance (as in the previous rows) excluding one-off and other temporary measures.
(3) There are no one-off and other temporary measures in the programme.
(4) There are no one-off and other temporary measures in the Commission services' autumn 2006 forecast.
(5) Based on estimated potential growth of 3,2 %, 3,1 %, 3,0 % and 2,9 % respectively in the period 2005-2008.

*Source:*

*Stability programme (SP); Commission services' autumn 2006 economic forecasts (COM); Commission services' calculations*