EUROPEAN COMMISSION

Brussels, 15.6.2010
SEC(2010) 746 final

Proposal for a

COUNCIL DECISION

on the existence of an excessive deficit in Finland

EXPLANATORY MEMORANDUM

1. THE APPLICATION OF THE STABILITY AND GROWTH PACT IN THE CURRENT CRISIS SITUATION

Many EU countries are presently facing general government deficits above the 3% of GDP reference value set in the Treaty. The often strong deterioration in the deficit as well as the debt positions must be seen in the context of the unprecedented global financial crisis and economic downturn in 2008/09. Several factors are at play. First, the economic downturn brings about declining tax revenue and rising social benefit expenditure (e.g. unemployment benefits). Second, recognising that budgetary policies have an important role to play in the current extraordinary economic situation, the Commission called for a fiscal stimulus in its November 2008 European Economic Recovery Plan (EERP), endorsed by the European Council in December. The Plan explicated that the stimulus should be timely, targeted and temporary and differentiated across Member States to reflect their different positions in terms of public finance sustainability and competitiveness and should be reversed when economic conditions improve. Finally, several countries have taken measures to stabilise the financial sector, some of which have impacted on the debt position or constitute a risk of higher deficits and debt in the future, although some of the costs of the government support could be recouped in the future.

The Stability and Growth Pact requires the Commission to initiate the excessive deficit procedure (EDP) whenever the deficit of a Member State exceeds the 3% of GDP reference value. The amendments to the Stability and Growth Pact in 2005 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, and thereby ensuring long-term sustainability of public finances.

2. PREVIOUS STEPS IN THE EXCESSIVE DEFICIT PROCEDURE

Article 126 of the Treaty on the Functioning of the European Union lays down an excessive deficit procedure (EDP). This procedure is further specified in 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.

According to Article 126(2) of the Treaty, the Commission has to monitor compliance with budgetary discipline on the basis of two criteria, namely: (a) whether the ratio of the planned or actual government deficit to gross domestic product (GDP) exceeds the reference value of 3% (unless either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value); and (b) whether the ratio of government debt to GDP exceeds the reference value of 60% (unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace).

[1] OJ L 209, 2.8.1997, p. 6. The report also takes into account the "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 10 November 2009, available at http://ec.europa.eu/economy_finance/sgp/legal_texts/index_en.htm.

Article 126(3) stipulates that, if a Member State does not fulfil the requirements under one or both of these criteria, the Commission has to prepare a report. This report also has to "take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State".

On the basis of the data notified by the Finnish authorities in April 2010[2]and taking into account the Commission services' spring 2010 forecast, the Commission adopted a report under Article 126(3) for Finland on 12 May 2010[3].

Subsequently, and in accordance with Article 126(4), the Economic and Financial Committee formulated an opinion on the Commission report on [27 May 2010].

3. THE EXISTENCE OF AN EXCESSIVE DEFICIT

According to the EDP notification, the general government deficit in Finland is planned to reach 4.1% of GDP in 2010, thus exceeding the 3% of GDP reference value. The Commission report under Article 126(3) considered that the planned deficit was not close to the 3% of GDP reference value. The third supplementary budget presented by the Ministry of Finance to the Parliament on 14 May 2010 suggests that tax revenues in 2010 could turn out by 0.5% of GDP higher-than-planned, principally on account of stronger corporate 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. The planned excess over the reference value can be qualified as exceptional within the meaning of the Treaty and the Stability and Growth Pact. In particular, it does result from a severe economic downturn in the sense of the Treaty and the Stability and Growth Pact and the stimulus measures taken as a response to the economic downturn in line with the European Economic Recovery programme. According to the Commission services' spring 2010 forecast, real GDP contracted by 7.8% in 2009 and is forecast to recover in 2010 at 1.4%. Furthermore, the planned excess over the reference value can be considered temporary. According to the Commission services' spring 2010 forecast, the deficit will fall below the reference value in 2011, supported by the projected economic recovery taking hold. The deficit criterion in the Treaty is not fulfilled.

According to the EDP notification, the general government gross debt remains below the 60% of GDP reference value at 49.9% of GDP in 2010. According to the Commission services' spring 2010 forecast, the debt ratio is forecast at 50.5% of GDP in 2010 and to increase to 54.9% of GDP in 2011. The debt criterion in the Treaty is fulfilled.

In line with the provisions in the Treaty and the Stability and Growth Pact, the Commission also analysed in its report "relevant factors". According to the Stability and Growth Pact, these can only be taken into account in the steps leading to the decision on the existence of an

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[2] According to Council Regulation (EC) No 479/2009, Member States have to report to the Commission, twice a year, their planned and actual government deficit and debt levels. The most recent notification of Finland can be found at: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/excessive_deficit/edp_notification_tables.

[3] All EDP-related documents for Finland can be found at the following website: http://ec.europa.eu/economy_finance/sgp/deficit/countries/index_en.htm.

excessive deficit if the deficit satisfies the double condition of closeness and temporariness. In the case of Finland, the double condition is not met. Considered on their own merit, the relevant factors in the current case on balance seem to be relatively favourable, based on the good track record of fiscal policy in Finland.

The opinion of the Economic and Financial Committee in accordance with Article 126(4) of the Treaty is consistent with the assessment in the Commission report under Article 126(3).

The Commission, having taken into account its report under Article 126(3) and the opinion of the Economic and Financial Committee under Article 126(4), is of the opinion that an excessive deficit exists in Finland. This opinion, adopted by the Commission on [15 June 2010], is herewith addressed to the Council according to Article 126(5). The Commission proposes that the Council shall decide accordingly, in conformity with Article 126(6). In addition, the Commission is submitting to the Council a recommendation for a Council Recommendation to be addressed to Finland with a view to bringing the situation of an excessive deficit to an end according to Article 126(7).

4. RECOMMENDATIONS TO END THE EXCESSIVE DEFICIT SITUATION

According to Article 3(4) of Council Regulation (EC) No 1467/97, the Council recommendation under Article 126(7) has to establish a deadline of six months at most for effective action to be taken by the Member State concerned 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”. Article 2(6) of the Regulation implies that the “relevant factors” considered in the Commission report under Article 126(3) of the Treaty have to be taken into account in deciding whether special circumstances exist. Article 3(4) of the Regulation specifies that the Council has to recommend that the Member State achieves a “minimum annual improvement of at least 0.5% of GDP as a benchmark, in its cyclically adjusted balance net of one-off and temporary measures, in order to ensure the correction of the excessive deficit within the deadline set in the recommendation”.

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. Against this background, it is appropriate to allow the Finnish authorities to implement the fiscal measures in 2010 as envisaged, while ensuring that the planned breach of the 3%-of-GDP reference value would remain contained and temporary. The authorities should specify measures to ensure that the planned correction of the excessive deficit in 2011 is sustained.

Enhanced surveillance under the EDP, which seems necessary in view of the deadline for the correction of the excessive deficit, will require regular and timely monitoring of the progress made in the implementation of the fiscal consolidation strategy to ensure the correction of the excessive deficit. In this context, a separate chapter in the 2011 update of the Finnish Stability Programme could usefully be devoted to this issue.

Comparison of key macroeconomic and budgetary projections

		2007	2008	2009	2010	2011
Real GDP (% change)	COM spring 2010	4.9	1.2	-7.8	1.4	2.1
	Min. of Fin. spring 2010	4.9	1.2	-7.8	1.1	2.1
Output gap (% of potential GDP)	COM spring 2010 [1]	5	4.1	-5	-4.6	-3.8
	Min. of Fin. spring 2010	n.a.	n.a.	n.a.	n.a.	n.a.
General government balance (% of GDP)	COM spring 2010	5.2	4.2	-2.2	-3.8	-2.9
	Min. of Fin. spring 2010	5.2	4.1	-2.4	-4.2	-2.2
Primary balance (% of GDP)	COM spring 2010	6.7	5.6	-1	-2.6	-1.7
	Min. of Fin. spring 2010	n.a.	n.a.	n.a.	n.a.	n.a.
Cyclically-adjusted balance (% of GDP)	COM spring 2010	2.6	2.1	0.3	-1.4	-1
	Min. of Fin. spring 2010	n.a.	n.a.	n.a.	n.a.	n.a.
Structural balance[2] (% of GDP)	COM spring 2010	2.6	2.1	0.4	-1.3	-1
	Min. of Fin. spring 2010	n.a.	n.a.	n.a.	n.a.	n.a.
Government gross debt (% of GDP)	COM spring 2010	35.2	34.2	44	50.5	54.9
	Min. of Fin. spring 2010	35.2	34.2	44	49.9	51.7

Notes:

[1] Based on estimated potential growth of 2.2%, 2.1%, 1.1%, 1.0 and 1.3% respectively in the period 2007-2011.

[2] Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are *specified as 0.1% of GDP in 2009 and 0.2% of GDP in 2010, both deficit-increasing* according to the Commission services' spring 2010 forecast.

Source:
Ministry of Finance spring 2010 forecast; Commission services' spring 2010 forecasts (COM); Commission services' calculations.

Proposal for a

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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(6) thereof,

Having regard to the proposal from the European Commission,

Having regard to the observations made by Finland,

Whereas:

(1) According to Article 126 of the Treaty on the Functioning of the European Union 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 excessive deficit procedure (EDP) under Article 126 of the treaty, as clarified by Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure[4] (which is part of the Stability and Growth Pact), provides for a decision on the existence of an excessive deficit. The Protocol on the excessive deficit procedure annexed to the Treaty sets out further provisions relating to the implementation of the EDP. Council Regulation (EC) No 479/2009[5] lays down detailed rules and definitions for the application of the provision of the said Protocol.

(4) 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

[4] OJ L 209, 2.8.1997, p. 6.
[5] OJ L 145, 10.6.2009, p. 1.

policies for a prompt return to sound budgetary positions taking account of the economic situation.

(5) Article 126(5) of the Treaty requires the Commission to address an opinion to the Council if the Commission considers that an excessive deficit in a Member State exists or may occur. Having taken into account its report in accordance with Article 126(3) and having regard to the opinion of the Economic and Financial Committee in accordance with Article 126(4), the Commission concluded that an excessive deficit exists in Finland. The Commission therefore addressed such an opinion to the Council in respect of Finland on [15 June 2010][6].

(6) Article 126(6) of the Treaty states that the Council should consider any observations which the Member State concerned may wish to make before deciding, after an overall assessment, whether an excessive deficit exists. In the case of Finland, this overall assessment leads to the following conclusions.

(7) According to the data notified by the Finish authorities in April 2010, the general government deficit in Finland is planned to reach 4.1% of GDP in 2010, thus exceeding the 3% of GDP reference value. While the third supplementary budget presented by the Ministry of Finance to the Parliament on 14 May 2010 suggests that tax revenues in 2010 could turn out higher-than-planned, this has not officially altered the deficit target. The planned deficit is not close to the 3% of GDP reference value, but the planned excess over the reference value can be qualified as exceptional within the meaning of the Treaty and the Stability and Growth Pact. In particular, it does result from a severe economic downturn in the sense of the Treaty and the Stability and Growth Pact. Furthermore, the planned excess over the reference value can be considered temporary. According to the Commission services' spring 2010 forecast, the deficit will fall below the reference value in 2011, supported by the projected economic recovery taking hold. The deficit criterion in the Treaty is not fulfilled.

(8) According to the data notified by the Finish authorities in April 2010, the general government gross debt remains below the 60% of GDP reference value at 49.9% of GDP in 2010. The Commission services' spring 2010 forecast projects the debt ratio to be at 50.5% of GDP in 2010 and to increase to 54.9% of GDP in 2011, still to remain below the 60% of GDP reference value. The debt criterion in the Treaty is fulfilled.

(9) According to Article 2(4) of Council Regulation (EC) No 1467/97, "relevant factors" can only be taken into account in the steps leading to the Council decision on the existence of an excessive deficit in accordance with Article 126(6) if the double condition - that the deficit remains close to the reference value and that its excess over the reference value is temporary - is fully met. In the case of Finland, this double condition is not met. Therefore, relevant factors are not taken into account in the steps leading to this decision.

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[6] All EDP-related documents for Finland can be found at the following website: http://ec.europa.eu/economy_finance/sgp/deficit/countries/index_en.htm.

HAS ADOPTED THIS DECISION:

Article 1

From an overall assessment it follows that an excessive deficit exists in Finland.

Article 2

This decision is addressed to the Republic of Finland.

Done at Brussels, 15.6.2010

For the Council
The President