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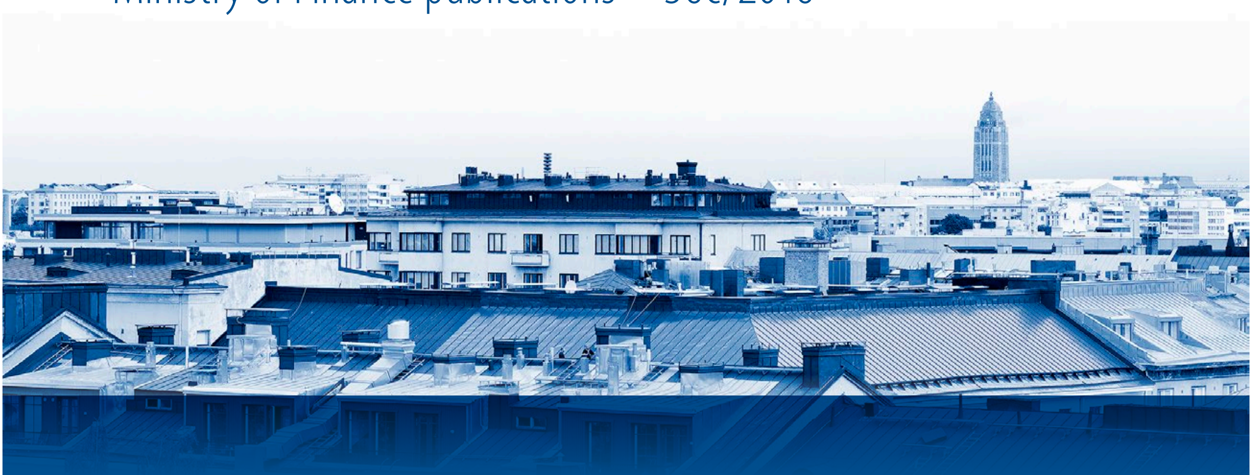

Economic Policy

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Abstract

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 sub-mit 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 draft budget, the goals of the European Union's strategy for growth and jobs and the country specific recommendations, and a comparison between the DBP and the most recent Stability Programme, as well as a methodological annex. Finland's draft budgetary plan for 2017 is based on the Government's 2017 draft budget submitted to Parliament on 15 September 2016, which for the most part is founded upon the spring 2016 spending limits decision, on the 2016 supplementary budgets and on the 2017 programme for local government finances.

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Tables

APPENDIX

The 2017 Draft Budgetary Plan presents an assessment of the development of Finland's general government finances in 2016 and 2017 as well as the Government's assessment of progress towards the medium-term objective.

Assessment of compliance with deficit and debt criteria

At the end of September 2016, Statistics Finland published updated general government deficit and debt statistics. According to Statistics Finland, the general government deficit was 2.8% in ratio to GDP in 2015. According to the Ministry of Finance's September 2016 forecast, the deficit will be 2.4% in ratio to GDP in 2016 and 2.6% in 2017. Finland will therefore meet the deficit criterion, in line with the European Commission's assessment in May 2016.

As a result of a change in a statistical method relating to earnings-related pension funds' derivative contract collaterals, general government debt is approximately EUR 2 billion greater (around one percentage point in ratio to GDP) in 2012–2015. The Draft Budgetary Plan has used updated statistical data that were not available when the national budget forecast published on 15 September 2016 was prepared. The updated debt figures and a comparison with the earlier figures are presented in Table 1:

	2015	2016	2017
Draft Budgetary Plan October 2016	63.6	65.3	66.7
Economic Survey September 2016	62.6	64.3	65.8
Stability Programme April 2016	63.1	65.0	66.7

Taking into account the change in the statistical method, Finland's debt ratio will rise to 65.3% in 2016 and to 66.7% in 2017. Relative to the Stability Programme, however, Finland's debt ratio is projected to rise in 2016 by only 0.3 percentage points, which is less than the change in the statistical method would require. Without the increase in the debt ratio resulting from the change in the statistical method, Finland's debt ratio would be projected to fall relative to the figure presented in the 2016 Stability Programme. This is due to a revision of the GDP estimate. The debt ratio projected for 2017, on the other hand, is expected to remain unchanged.

Due to the earnings-related pension funds' inclusion in the public sector, the net financial assets of Finland's public sector are among the highest of the OECD countries, and rose at the end of 2015 to 52½% of GDP. Owing to the surplus of the earnings-related pension funds, stock-flow adjustments have a significant impact on the development of debt in Finland. In principle, the gross debt of Finland's public sector could be reduced by directing earnings-related pension fund investments into central government bonds. To safeguard the adequacy of pensions, however, it is considered important that earnings-related pension fund assets are invested on commercial grounds and that no efforts are made to direct them on political grounds. The 2015 stock-flow adjustment is explained, in line with the Commission's spring assessment, by 40% of the change in debt-to-GDP ratio. The Commission's view in May was that Finland will meet the debt criterion, even though general government debt exceeded the 60% reference value in 2015. The fulfilment of the debt criterion was based, on the one hand, on so-called cyclically-adjusted debt remaining below the 60% limit and, on the other hand, on compliance with the preventive arm of the Stability and Growth Pact. Despite the statistical correction, it can be expected that the debt criterion will still be met, particularly due to the fulfilment of the requirements of the preventive arm, which will be assessed in the following paragraph.

The medium-term objective and compliance with the requirements of the preventive arm of the Stability and Growth Pact

Finland is still within the preventive arm of the Stability and Growth Pact and is subject to the requirements of the preventive arm that relate to progress towards the medium-term objective. The achievement of the medium-term objective or progress towards it are assessed with the aid of two pillars, the change in the structural balance and the expenditure benchmark.

Finland's medium-term objective (MTO) for the structural budgetary position is -0.5% in ratio to GDP. The Government aims to achieve the MTO at the latest in 2019. A key role will be played by the EUR 4 billion consolidation measures implemented by the Government and the Competitiveness Pact as well as, if necessary, supplementary measures aimed at ensuring that the public finance-enhancing effects of the Government's measures are implemented on the scale set as a target in the Government Programme.

Finland is required, in accordance with the country-specific recommendations approved by the Council in July 2016, to make a structural adjustment towards the medium-term objective of 0.5% in ratio to GDP in 2016. In 2017 the adjustment requirement is 0.6% in ratio to GDP.

The Commission's assessment in the spring was that Finland complied with the requirements of the preventive arm in 2015. The structural balance improved 0.3 % in ratio to GDP in 2015 to stand at -1.2% of GDP. The required adjustment had been set in spring 2014 at 0.1% in ratio to GDP but, taking increased refugee costs into account, the required adjustment fell by 0.05% of GDP. (see the information box and table below). The adjustment therefore exceeded the required figure. Finland complied with the expenditure benchmark in 2015 by a margin of 0.8% percentage points.[1]

[1] A cumulative estimate was not made for 2014–2015, as in 2014 growth was negative.

Pursuant of Article 6(3) of Council Regulation (EC) No 1466/97, a divergence from the medium-term objective, or an appropriate adjustment path towards it, may also be overlooked if it is due to an unusual event that is beyond the control of the Member State and that has a major impact on the general government budgetary position, provided that this does not jeopardise the medium-term sustainability of general government finances. The increased costs of immigration in 2015–2016 due to the refugee crisis meet the definition of Article 6(3).

Increased immigration expenditure is calculated as follows. Expenditure for 2015 is compared with 2014 and correspondingly expenditure for 2016 is compared with 2015. Countries must apply to take refugee costs into account in the Draft Budgetary Plan or in a corresponding document. The application must present an itemised analysis of where the increased costs have arisen. For example, costs arising from enhanced border control are not suitable grounds.

Immigration costs have increased in Finland as a result of the refugee crisis. In 2015 no fewer than 32,476 asylum seekers arrived in Finland, whereas 3,651 refugees arrived in 2014. In 2016, by mid-September, 4,455 asylum seekers had arrived.

The additional costs arising from increased immigration totalled EUR 109 million in 2015, i.e. 0.05% in ratio to GDP. As immigration accelerated during 2015, the costs of immigration grew further this year. As matters stand, the largest growth in increased costs of immigration as a result of the refugee crisis will take place in 2016. (Table 2). Immigration costs will grow this year by EUR 641 million, i.e. 0.3% in ratio to GDP.

Table 2. Impact of increased immigration on general government budgetary position, according to national accounts, EUR million

	2014	2015	2016
1. Compensation of employees	70	111	320
2. Intermediate consumption	192	250	511
3. Social income transfers	10	20	200
4. Subsidies			
5. Gross fixed capital formation			
6. Capital transfers			
7. Others			
8. Impact on budgetary position	272	381	1031
9. Compensations from the EU			9
10. Impact on budgetary position excl. contributions from EU (10) = (8) - (9)	272	381	1023
in ratio to GDP	0.13	0.18	0.48

According to the Ministry of Finance's forecast, in 2016 the structural balance will improve very slightly to stand at -1.2% of GDP[2]. The required adjustment again takes into account the impact of increased refugee costs, which will be felt mainly in 2016. According to a Finnish Immigration Service estimate, growth of refugee costs has been revised to 0.3% of GDP. Therefore the required adjustment in 2016 will fall from 0.5% to 0.2% of GDP. The deviation from the required adjustment is 0.2% of GDP. This is not a significant deviation.[3] Cumulatively, the required adjustment was achieved in 2015–2016. The expenditure benchmark will again be met in 2016, with a margin of 0.3 percentage points. The expenditure benchmark will also be met cumulatively in 2015–2016. As the deviation in the change of the structural balance is minor and as the expenditure benchmark will be met with a clear margin, Finland will fulfil the requirements of the preventive arm in 2016.

According to the Ministry of Finance's autumn 2016 forecast, the structural balance in 2017 will be -1.6% in ratio to GDP. The deviation relative to the required adjustment is nearly one percentage point. The cumulative deviation for 2016–2017 will be 0.6% of GDP, when the increased costs of immigration in 2016 are taken into account in the required adjustment. In 2017 the deviation from the expenditure benchmark will be 0.85%.[4] The cumulative deviation will be 0.28%. If the projected figures are realised, there is a risk that a significant deviation in the requirements of the preventive arm will arise in 2017.

The deviation of the structural balance from the required adjustment in 2017 will arise from the significant structural reforms implemented by the Government, which have involved significant ex ante costs. It should be particularly noted that to achieve the Competitiveness Pact the Government has committed to tax concessions in 2017. The net impact of the Competitiveness Pact will be EUR -1,200 million, i.e. -0.55% in ratio to GDP in 2017. If the impact of the Competitiveness Pact were removed from the change in the structural balance, the structural balance would improve in 2017 by nearly 0.2 % of GDP. The deviation from the required adjustment would therefore only be just under 0.4% of GDP.

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[2] Strictly speaking, the structural balance will improve by three hundredths of one per cent: in 2015 -1.25%, in 2016 -1.22% of GDP.

[3] In an analysis of the structural balance and the expenditure benchmark, a significant deviation, 0.5% of GDP, may be formed in two different ways. Firstly, a significant deviation may be formed if in one period there is a deviation from the required change in the structural balance of 0.5 percentage points (in ratio to GDP). Secondly, a significant deviation may be formed if the average of deviations in two consecutive periods is more than 0.25 percentage points. The aim of the latter definition is to prevent situations in which there is a slight deviation from the required change in the structural balance every year, in which case the cumulative deviation may gradually become great. In the expenditure benchmark, a deviation is calculated as a deviation of net expenditure and of the objective set for its growth.

[4] In 2017 the expenditure benchmark is considerably tighter than in earlier years, because Finland has not achieved the medium-term objective, growth of Finland's medium-term potential output has slowed and more adjustment is required from Finland.

Major structural reforms implemented and planned by the Finnish Government

On the basis of Council Regulation (EC) No 1466/97, Member States that have implemented significant structural reforms can deviate temporarily from the medium-term objective or progress towards it.[5]

The Finnish Government has implemented and is preparing significant structural reforms that will have a significant strengthening impact on public finances in the longer term. These reforms respond directly to the country-specific recommendations given to Finland in 2011–2016.[6]

A pension reform will come into force at the beginning of 2017. The lowest old-age pension age will rise gradually in the period 2018–2027 from 63 to 65 years. From 2030 the retirement age will be linked to life expectancy so that the ratio of years spent in work to years spent in retirement will remain at the 2025 level. The reform is expected to reduce pension expenditure in ratio to GDP by more than one half of one percentage point and will also remove the need to increase pension contributions. The pension reform is expected to reduce the sustainability gap in general government finances by approximately one percentage point. The projected effects of the pension reform are outlined in Appendix 1.

In summer 2017, the Government and social partners signed the Competitiveness Pact, which will enhance the price competitiveness of Finnish production. Under the pact, unit labour costs of production will fall by approximately 4%. The tax concessions included in the pact will adversely affect the general government budgetary position in 2017, but the positive effects will be evident later. According to estimates, in the longer term the pact will enable the creation of approximately 40,000 new jobs. The projected effects of the Competitiveness Pact are outlined in Appendix 2.

The Government has negotiated in a tripartite working group an employment package. The objective is to raise the employment rate of 15–64 year-olds to 72% and increase the number of people in employment by 110,000 during the current parliamentary term. The working group submitted a report, which covered, among other things, the gradation of unemployment security.

The Government is preparing a health and social services reform and a regional government reform to ensure that the system corresponds better with the needs of an ageing society. The intention is to create 18 counties, which would assume responsibility for the organisation of health and social services as well as other duties that are currently the responsibility of the municipalities. The Government's draft law was circulated for comment at the end of August 2016.

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5 When defining the adjustment path to the medium-term budgetary objective for Member States that have not yet reached this objective and in allowing a temporary deviation from this objective for Member States that have already reached it, under the condition that an appropriate safety margin with respect to the deficit reference value is preserved and that the budgetary position is expected to return to the medium-term budgetary objective within the programme period, the Council shall take into account the implementation of major structural reforms that have direct long-term cost-saving effects, including by raising potential growth, and therefore a verifiable impact on the long-term sustainability of public finances.

6 Pension reform: see recommendations given to Finland in 2011, 2012, 2013, 2014 and 2015. Labour market or Competitiveness Pact: see recommendations given to Finland in 2011, 2012, 2013, 2014, 2015 and 2016.

Utilising the structural reform clause

According to guidelines agreed by the Economic and Financial Affairs Council (Ecofin) and the Commission[7], the structural reform clause can be utilised if the structural reforms are major, they have direct long-term budgetary effects, and they are fully implemented. There is flexibility associated with the last-mentioned criterion, however, taking into account the fact that the implementation of structural reforms may take several years. With respect to on-going structural reforms, a dedicated structural reform plan should be presented in connection with the national reform programme (NRP).

Furthermore, according to the guidelines on the application of the structural reform clause, the following conditions must be met:

i) the reforms must meet the above criteria;
ii) the temporary deviation from the adjustment path to the MTO does not exceed 0.5% of GDP;
iii) the cumulative temporary deviation from the adjustment path to the MTO of the investment and structural reform clauses does not exceed 0.75% of GDP (same condition as in the investment clause item in appendix 3);
iv) in the event that the structural reform is planned but not yet fully implemented, the Commission and the Council will set the required adjustment for the year t+1 in accordance with the preventive arm, without any deviation from the adjustment path to the MTO;
v) the MTO must be achieved within four years from the activation of the clause, and the maximum deviation of the structural balance from the MTO is 1.5% of GDP in year t;
vi) once the Member State has benefitted completely from the temporary deviation from the MTO (a maximum of 0.5% of GDP) facilitated by the structural reform clause, it is not allowed to benefit again from the clause until it has attained its MTO (see investment clause item below); and
vii) an adequate safety margin must be maintained with respect to the 3% of GDP reference value for the general government deficit.

With respect to Finland, fulfilment of the conditions can be assessed as follows. The structural reforms undertaken by Finland meet the required conditions and correspond directly to the country-specific recommendations given to Finland. More detailed information on the reforms is presented in Appendices 1 and 2.

The deviation of the structural balance from the MTO is less than 1.5% of GDP, and progress towards the MTO will continue in 2018. The Government objective remains the achievement of the MTO in 2019.

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[7] Guidelines formally approved by the Ecofin Council on 12 February 2016 "Commonly agreed position on Flexibility within the SGP", http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/2015-01-13_communication_sgp_flexibility_guidelines_en.pdf

Finland will stay clearly below the 3% of GDP deficit reference value in the coming years. In fact, the 3% limit has not been violated, with the exception of 2014, when the deficit surprisingly exceeded the 3% limit due to the ESA 2010 statistics reform. Finland will not, however, meet the final safety margin condition relating to the deficit reference value in the manner required by the Code of Conduct of the Stability and Growth Pact, according to which a Member State's structural balance must meet the minimum benchmark condition.[8] At the end of 2016, Finland will be close to meeting the condition, but the projected deterioration of the structural balance in 2017 means that it will fall short.

Finland applies for the utilisation of the structural reform clause in 2017. Although the fulfilment of all the technical conditions of the clause cannot currently be verified, the Government's structural reform programme is critical for the adjustment of the economy and in accordance with the spirit of the said clause and it does not jeopardise the maintenance of an adequate safety margin with respect to the 3% reference value. Due to uncertainties associated with the assessment of the structural balance as well as other uncertainties, it is also possible that in ex-post assessment the technical conditions will be found to be fulfilled. Thus it is would at least be possible for Finland to return to utilising the structural reform clause in later assessments. If it is considered possible for Finland to utilise the structural reform clause, it would also be able to utilise the investment clause in 2017. This has been assessed in Appendix 3.

Government's assessment of progress towards the medium-term objective

The Government agrees with the above assessment of progress towards the medium-term objective. According to the assessment, Finland has approached the MTO in 2016 in the manner required in the country-specific recommendations. With respect to 2017, the deviation from the requirements of the preventive arm is largely explained by costs arising to achieve the Competitiveness Pact. If necessary, the Government will react to the situation in connection with the preparation of the spring 2017 General Government Fiscal Plan.

Pursuant of Section 3.1 of the FIPO 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 medium-term objective.

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8 As the safety margin is used the minimum benchmark of the structural balance objective, the calculation of which is outlined in Appendix 2 of the Vade Mecum. In 2016 a minimum benchmark of -0.5 will be applied to Finland, which corresponds to Finland's MTO. In practice, the condition completely excludes Finland from using the flexibility elements. In 2017 a minimum benchmark of -1.1 will be applied to Finland, which therefore permits the use of the flexibility clauses if the other conditions are met. Based on current knowledge, Finland's structural balance will not meet the minimum benchmark requirement, which may constitute a barrier to the use of the flexibility clauses. It is possible, however, that the structural balance may, in the ex post assessment to be carried out in spring 2018, change from the present estimate and the condition will as a consequence be met. Both of Finland's minimum benchmarks, for 2013–2016 and 2017–2019, are below the average values of Member States (approximately -1.6 in both periods), i.e. the minimum bench for Finland is clearly tighter than for other countries.

1. Macroeconomic forecasts[1]

Table 0.i) Basic assumptions

	2015	2016	2017
3-month Euribor	0.0	-0.3	-0.3
Long-term interest rate (10-year government bonds)	0.7	0.3	0.4
USD/€ exchange rate	1.1	1.1	1.1
Nominal effective exchange rate	-3.0	0.9	0.0
World GDP growth (excl. The EU)	3.2	3.3	3.7
EU-27 GDP growth	2.0	1.8	1.9
Growth of relevant foreign markets	2.4	1.3	3.1
World trade growth	2.4	2.0	3.2
Oil prices. (Brent. USD/barrel)	53	44	49

Table 1a. Macroeconomic prospects

	2015 level bn. EUR	2015	2016	2017
		change, %		
1. Real GDP	186. 8	0.2	1.1	0.9
Of which				
1.1. Attributable to the estimated impact of aggregated budgetary measures on				
2. Potential GDP	191.9	0.0	0.4	0.5
contributions:				
- labour				
- capital				
- total factor productivity				
3. Nominal GDP	209.1	1.8	1.9	2.1
Components of real GDP				
4. Private final consumption expenditure	115.7	1.5	1.2	0.7
5. Government final consumption	51.0	0.4	-0.1	-1.3
6. Gross fixed capital formation	42.7	0.7	4.3	3.3
7. Changes in inventories and net acquisition of valuables (% of GDP)	1.4	0.7	0.6	0.7
8. Exports of goods and services	76.6	-0.2	1.0	3.0
9. Imports of goods and services	77.5	1.9	2.0	2.9
Contributions to real GDP growth, % points	0.0	0.0	0.0	0.0
10. Final domestic demand	209.5	1.0	1.5	0.8
11. Changes in inventories and net acquisition of valu-ables	1.4	-0.8	-0.4	0.0
12. External balance of goods and services	-1.0	0.0	-0.1	0.1

[1] 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 2 September 2016 and, in addition, the Government's 2017 Budget Proposal, which was submitted to Parliament on 15 September 2016.

Table 1b. Price developments

	2015	2016	2017
	change, %		
1. GDP deflator	1.6	0.9	1.2
2. Private consumption deflator	0.4	0.4	1.1
3. HICP	-0.2	0.4	1.1
4. Public consumption deflator	0.2	1.2	0.5
5. Investment deflator	0.4	1.7	2.3
6. Export price deflator	-0.9	-2.0	1.3
7. Import price deflator	-4.0	-2.0	1.3

Table 1c. Labour market developments

	2015 level	2015	2016	2017
		change, %		
1. Employment, 1 000 persons	2 437	-0.4	0.4	0.3
2. Employment, 1 000 000 hours worked	4 099	-0.1	1.0	1.5
3. Unemployment rate (%)	252	9.4	9.0	8.8
4. Labour productivity, persons	76.7	0.6	0.7	0.6
5. Labour productivity, hours worked	45.6	0.3	0.1	-0.6
6. Compensation of employees	102.5	1.0	2.0	-0.7
7. Compensation per employee	42.0	1.4	1.6	-1.0

Table 1d. Sectoral balances

	2015	2016	2017
	% of GDP		
1. Net lending/borrowing vis-à-vis the rest of the world	-0.8	-1.1	-1.1
of which:			
- Balance on goods and services	-1.4	-0.9	-0.9
- Balance of primary incomes and transfers	-0.4	-1.0	-0.4
- Capital account	0.1	0.1	0.1
2. Net lending/borrowing of the private sector	1.6	0.9	1.1
3. Net lending/borrowing of general government	-2.8	-2.4	-2.6
4. Statistical discrepancy	0.4	0.4	0.4

2. Budgetary Targets

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

Net lending (+) / net borrowing (-) by sub-sector	2016	2017
	% of GDP	
1. General government	-2.4	-2.6
2. Central government	-2.8	-2.8
3. -	-	-
4. Local government	-0.5	-0.4
5. Social security funds	0.9	0.7
6. Interest expenditure	1.1	1.0
7. Primary balance	-1.2	-1.5
8. One-off and other temporary measures	0.0	0.0
9. Real GDP growth (%)	1.1	0.9
10. Potential GDP growth (%)	0.4	0.5
contributions:		
- labour		
- capital		
- total factor productivity		
11. Output gap	-2.0	-1.7
12. Cyclical budgetary component	-1.2	-1.0
13. Cyclically-adjusted balance	-1.2	-1.6
14. Cyclically-adjusted primary balance	-0.1	-0.6
15. Structural balance	-1.2	-1.6

Table 2b. General Government debt developments

	2016	2017
	% of GDP	
1. Gross debt	65.3	66.7
2. Change in gross debt ratio	1.6	1.5
Contributions to changes in gross debt		
3. Primary balance	-1.2	-1.5
4. Interest expenditure	1.1	1.0
5. Stock-flow adjustment	-0.7	-1.1
of which:		
- Differences between cash and accruals		
- Net accumulation of financial assets3		
of which:		
- privatisation proceeds		
- Valuation effects and other		
p.m.: Implicit interest rate on debt	1.8	1.6
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	2016	2017
	% of GDP	
1. Total revenue at unchanged policies	54.4	54.3
Of which		
1.1. Taxes on production and imports	14.2	14.0
1.2. Current taxes on income, wealth, etc	16.8	16.7
1.3. Capital taxes	0.2	0.2
1.4. Social contributions	12.8	12.7
1.5. Property income	2.8	2.9
1.6. Other	7.9	7.8
p.m.: Tax burden	44.1	43.7
2. Total expenditure at unchanged policies	57.8	57.8
Of which		
2.1. Compensation of employees	13.7	13.2
2.2. Intermediate consumption	11.7	11.7
2.3. Social payments	22.8	23.2
of which Unemployment benefits	2.6	2.5
2.4. Interest expenditure	1.1	1.0
2.5. Subsidies	1.3	1.3
2.6. Gross fixed capital formation	4.0	4.1
2.7. Capital transfers	0.4	0.4
2.8. Other	2.8	2.8

4. Expenditure and Revenue targets

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

General government	2016	2017
	% of GDP	
1. Total revenue target	55.0	54.0
Of which		
1.1. Taxes on production and imports	14.3	14.2
1.2. Current taxes on income, wealth, etc	16.7	16.3
1.3. Capital taxes	0.2	0.2
1.4. Social contributions	13.1	12.6
1.5. Property income	2.8	2.9
1.6. Other	7.9	7.8
p.m.: Tax burden	44.4	43.3
2. Total expenditure target	57.4	56.6
Of which		
2.1. Compensation of employees	13.6	12.9
2.2. Intermediate consumption	11.6	11.6
2.3. Social payments	22.8	22.8
of which Unemployment benefits	2.6	2.5
2.4. Interest expenditure	1.1	1.0
2.5. Subsidies	1.2	1.2
2.6. Gross fixed capital formation	4.0	4.1
2.7. Capital transfers	0.4	0.4
2.8. Other	2.7	2.5

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

	EUR million	2015	2016	2017
		% of GDP		
1. Expenditure on EU programmes fully matched by EU funds revenue	1 115	0.5	0.5	0.5
2. Cyclical unemployment benefit expenditure	1 015	0.5	0.4	0.4
3. Effect of discreationary revenue measures	628	0.3	0.3	-0.7
4. Revenue increases mandated by law	50	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		
					2016	2017	2018
					of GDP %		
Personal income tax	Personal income tax		accrual	partly decided**	-0.2	-0.3	-0.1
Corporate income tax	Corporate income tax		accrual	partly decided**	0.1	0.1	0.0
Indirect taxes	Indirect taxes		accrual	partly decided**	0.1	0.0	-0.1
Contributions	Contributions		accrual	proposal***	0.3	-0.4	0.1
Expenditure measures, total	Expenditure measures, total		accrual, cash-based	partly decided**	-0.4	-0.9	-0.2

* 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 2016

***Ministry of Social Affairs and Health will confirm during fall 2016

Table 5b. Discretionary measures taken by Central Government

List of measures	Detailed description	Target	Accounting principle	Adoption in status	Budgetary impact		
					2016	2017	2018
					of GDP %		
Personal income tax	Personal income tax		accrual	partly decided**	-0.2	-0.3	-0.1
Corporate income tax	Corporate income tax		accrual	partly decided**	0.1	0.1	0.0
Indirect taxes	Indirect taxes		accrual	partly decided**	0.1	0.0	-0.1
Expenditure measures, total	Expenditure measures, total		accrual, cash-based	partly decided**	-0.4	-0.7	-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 2016

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
CSR1: Achieve an annual fiscal adjustment of at least 0.5% of GDP towards the medium-term budgetary objective in 2016 and 0.6% in 2017; use any windfall gains to accelerate the reduction of the general government debt ratio; ensure timely adoption and implementation of the administrative reform with a view to better cost-effectiveness of health and social services;	Government will implement the measures decided on in the Government Programme. Draft laws on the health, social services and regional government reform were circulated for comment on 31 August 2016.	The measures respond directly to the recommendation
CSR2: While respecting the role of social partners, ensure that the wage setting system enhances local wage bargaining and removes rigidities, contributing to competitiveness and a more export industry-led approach; increase incentives to accept work and ensure targeted and sufficient active labour market measures, including for people with a migrant background; take measures to reduce regional and skills mismatches;	The Government and social partners signed the Competitiveness Pact in June 2016.	The measures respond directly to the recommendation .
Continue pursuing efforts to increase competition in services, including in retail; promote entrepreneurship and investment, including by reducing administrative and regulatory burden, to foster growth of high value added production.	The opening hours of retail shops, barbers and hairdressers were liberalised from the beginning of 2016. Phase 1 of the Transport Code was submitted to Parliament on 22 September 2016.	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 2016

See: http://ec.europa.eu/europe2020/pdf/csr2016/nrp2016_finland_en.pdf

7. Divergence from latest SP

Table 7. Divergence from latest SP

	2015	2016	2017
	% GDP		
Target general government net lending/net borrowing			
Stability Programme	-2.7	-2.5	-2.1
Draft Budgetary Plan	-2.8	-2.4	-2.6
Difference *	0.0	0.2	-0.5
General government net lending projection at unchanged policies			
Stability Programme	-2.7	-3.2	-3.4
Draft Budgetary Plan	-2.8	-3.4	-3.6
Difference *	0.0	-0.2	-0.1

APPENDIX 1: 2017 pension reform

The pension reform, which comes into force from the beginning of 2017, makes provision for an increase in life expectancy. Parliament passed the laws concerning the reform on 20 November 2015. Legislative preparation was based on an agreement on the main lines of the reform negotiated by social partners in September 2014.

The Ministry of Finance estimates that the reform will reduce the sustainability gap in general government finances by around one percentage point. The reform will promote employment and secure the funding of earnings-related pensions, an adequate level of pensions and equality between the generations and genders. The reform is intended to ensure that the retirement age expectancy will rise to at least 62.4 years by 2025. The reform also includes development measures that promote continuing and coping in work.

Main aspects of the reform

The lowest old-age retirement age of the earnings-related pension system will initially be increased gradually by two years. From 2018, the lowest old-age pension age will rise from the present 63 years by three months for each age cohort, until it is 65 years in 2027. The upper age limit of the old-age pension is five years higher than the lower limit, but it will rise, however, in whole years.

The old-age retirement age will be linked to life expectancy as of 2030 so that the time spent working in relation to the time spent in retirement will remain at the 2025 level. The age limit will rise annually by at most two months. To maintain the time spent working in relation to the time spent in retirement, the development of working careers as well as the economic and social sustainability of the entire earnings-related pension system will be regularly analysed. Development will be monitored on a tripartite basis, led by the Ministry of Social Affairs and Health, at five-year intervals from 2026.

The life expectancy coefficient will be retained, but it will be calculated in a more lenient manner than currently as of 2027, at which time the retirement age for all age cohorts will be 65 years.

Alongside the disability pension there will be a new form of pension, a years-of-service pension, which can be applied for at the age of 63. From 2030, the age limit for the years-of-service pension will be adjusted so that it is two years lower than the old-age pension. The requirement for receiving the pension is a 38-year working career which, with a few minor expectations, has been in work that is physically or mentally wearing. A further requirement of the years-of-service pension is an impairment of the individual's working capacity due to illness, handicap or disability as well as an impairment of opportunities to continue in work. The amount of the years-of-service pension is smaller than the disability pension, because the pension is not projected to retirement age[9]. The The projected pensionable ser-

[9] By projected pensionable service is meant the period between retirement on disability pension (pension event) and the lowest old-age pension age. The projected pensionable service increases, on certain conditions, the disability pension, because it was not possible to accrue a full pension for the curtailed working career.

vice of the disability pension, on the other hand, is linked to the lower limit of the old-age pension, which increases these pensions as the retirement age rises.

The present part-time pension will be abolished and replaced by a partial early old-age pension. An individual can draw part of the accrued old-age pension at the age of 61 years; after 2025 the age limit will rise to 62 years. From 2030, the age limit will always be three years lower than the lowest old-age pension age. Either 25% or 50% of the accrued pension can be drawn. Drawing the pension early reduces the drawn part of the pension permanently by 0.4% per month, i.e. 4.8% per year. The current requirement relating to part-time work will be abolished, i.e. no pay or working hours monitoring is associated with the new form of pension. The partial early old-age pension will not prevent an individual from receiving unemployment benefit nor will it reduce unemployment benefit.

The higher accruals of earnings-related pension will be abolished so that in future the annual pension accrual rate will be 1.5% of wages. With respect to pension accrual, however, there will be a transition period for 53–62 year-olds. During the transition period, pension will accrue at 1.7% per year until the end of 2025, but the employee's pension contributions will be correspondingly 1.5% higher than they otherwise would be. In addition, accrual of pension will begin to be calculated for higher earnings than at present, because the earnings-related pension insurance contribution will no longer be deducted from pensionable earnings.

The current 4.5% accrual for work done after reaching the lowest old-age pension age will be replaced by an increment for deferred retirement. If an individual does not draw the old-age pension immediately on reaching the earliest old-age pension age, the accrued pension will be adjusted by a 0.4% increment for each month of deferred retirement.

From 2023, the minimum age of eligibility for the right to additional days of unemployment security (so-called unemployment path to retirement) will be raised by one year to 62 years if social partners consider in 2019 that the measures agreed in the 2012 working careers agreement have been effective as intended.

In connection with the pension reform, social partners agreed that the private sector's earnings-related pension contribution will be frozen at the level of 24.4% for the period 2017–2019. According to calculations of the Finnish Centre for Pensions, this level of contribution will be sufficient to fund pensions even after 2019, all the way to the end of the 2060s. Alternatively, the contribution may be lowered from the end of the 2020s. In that case, the amount of private sector pension assets in relation to the insured wage bill would remain at a lower level, and in the long term the contribution would accordingly have to be increased more quickly as pension expenditure grew.

Peer review of pension reform by the Working Group on Ageing Populations and Sustainability

The 2017 pension reform has not yet been peer reviewed by the Working Group on Ageing Populations and Sustainability (AWG) of the EU's Economic Policy Committee. In the peer-reviewed pension calculations of the 2015 Ageing Report, however, one scenario was the 2017 pension reform. One scenario of the sensitivity analysis of the pension calculations was a policy scenario in which the retirement age is linked to life expectancy. In the case of Finland, the 2017 pension reform was examined instead of this scenario, although the timing of the increase of the retirement age is different than in the policy scenario. According to the calculations, the reform will reduce expenditure in ratio to GDP by approximately 0.5 percentage points compared with the baseline scenario starting from the 2030s (see Table 1 for more details). In the calculations, GDP growth will accelerate in the period 2020–2060 on average by slightly more than 0.1 percentage points per year.

Table 1. Development of pension expenditure in ratio to GDP in the 2015 Ageing Report

	2013	2020	2030	2040	2050	2060
Pension expenditure, baseline scenario (% / GDP)	13.4	14.8	15.6	14.1	13.3	13.5
Impact of 2017 pension reform (deviation from baseline scenario, percentage points)		0.0	-0.6	-0.7	-0.8	-0.6

Impact assessments of the Finnish Centre for Pensions

The projections underlying the impact assessments of the Government bill passed by Parliament were made using the long-term projection model of the Finnish Centre for Pensions (ETK).[10] The ETK estimates that the reform will postpone retirement by 1.3 years by the year 2040 and by nearly two years by 2080, when the expected effective retirement rate is used as an indicator. In the long term, the reform will increase the employment rate of 15–74 year-olds by approximately two percentage points. As a result of, on the one hand, the amended rules concerning how pensions are determined and, on the other, the extension of working careers, average pensions are projected to rise.

The basic assumptions of the ETK's projections and sensitivity analysis of them are outlined more extensively in the ETK's preliminary impact assessment.[11] The main assumptions in the ETK's projections are the impact of the pension reform on various transition probabilities. In the projections, the development of old-age pension retirement rates has been estimated by translating the retirement rates of younger age cohorts to older age groups with an general increase added. With respect to retirement on old-age pension, the projection largely focuses on the lowest old-age pension age and the year following this. Towards the end of the forecast horizon, this phenomenon is strengthened due to increases in the age limits.

[10] The calculations are presented in more detail in Finnish in the publication http://www.etk.fi/julkaisu/laskelmia-vuoden-2017-tyoelakeuudistuksen-vaikutuksista-hallituksen-esitykseen-perustuvat-arviot/. The publication has also been translated into English: http://www.etk.fi/julkaisu/effects-of-the-2017-earnings-related-pension-reform-projections-based-on-the-government-bill/

[11] The publication is available in Finnish at the following address: http://www.etk.fi/julkaisu/laskelmia-vuoden-2017-tyoelakeuudistuksen-vaikutuksista/

In the high retirement rate alternative of the sensitivity analysis, the number of people retiring on old-age pension rises so that after 2022 all of the insured retire at the latest at the lowest old-age pension age. In the baseline projection of the pension reform, the expected effective retirement age deviates in 2022 by around one year from the high retirement rate projection, while by 2060 the difference narrows to around half a year. In the high retirement rate alternative, pension expenditure as a percentage of gross domestic product grows by 2025 approximately 0.5 percentage points higher than the reform agreement projection as the number of pensioners grows quickly. Thereafter, the shorter working careers begin to be reflected in a lowering of the average pension compared with the agreement projection, and pension expenditure in ratio to GDP returns to the level of the agreement projection.

The number of people retiring on disability pension is also expected to grow with age after the lower limit of the present old-age pension age is reached. There is only limited data on the development of working capacity at these ages, however, because possible people with working incapacity are on old-age pension. In 1996–2011, the age-standardised disability pension retirement rate declined on average by 1.1% per year. In the projection, this trend has continued, although the rate at which the number of new retirees declines slows steadily. Between 2015 and 2060, the level of people retiring on disability pension declines in the projection overall by approximately 15%.

In the sensitivity analyses, the number of people retiring on disability pension is 25% lower or 25% higher than the reform agreement projection by 2060. In the low retirement rate alternative, the number of people retiring is around 36% lower in 2060 than in 2015, and in the high retirement rate alternative correspondingly around 6% higher. In the high retirement rate alternative, the earnings-related pension expenditure percentage will rise in the long term to a level just over one percentage point higher than the baseline scenario and in the low retirement alternative correspondingly to a level just over one percentage point lower.

With respect to the years-of-service pension, it is assumed that 2.5% of working men and 2% of working women who have reached the lower age limit of the years-of-service pension will retire on the years-of-service pension each year. In the high retirement rate alternative, the retirement rates of each age cohort are doubled and the percentage of people retiring on earnings-related pension grows slightly compared with the baseline scenario.

The partial old-age pension retirement rate is assumed to be of the same magnitude as the present part-time pension retirement rate. Its popularity is difficult to predict, however. The high retirement rate alternative for the partial old-age pension, the retirement rate of each age cohort is double compared with the agreement projection, in which case the expenditure associated with it is also roughly double. In the higher retirement rate alternative, pension expenditure in ratio to GDP will grow only slightly, however.

The conditionally agreed raising of the right to additional days of unemployment security by one year for those born in 1961 and later is assumed to be implemented. This will increase employment, but will not affect the timing of retirement.

Impact assessments of the Research Institute of the Finnish Economy

The effects of the pension reform have also been assessed by the Research Institute of the Finnish Economy (ETLA) in a report commissioned with the appropriations of the analysis, assessment and research activities supporting the decision-making of the Government.[12]

According to the baseline projection made using ETLA's stochastic life-cycle simulation model, the pension reform will extend working careers by 2025 by an average of approximately 5 months compared with a situation where the pension reform would not be implemented. By 2035 working careers will be extended by approximately 9 months. A benchmark for these impact assessments is a baseline scenario in which employment develops in the same way as in the assessment of the Finnish Centre for Pensions. In this scenario, employment of older people also develops relatively positively without the pension reform.

Based on a simulation made using ETLA's generation model, the economy will adjust in many ways to the higher employment rates of older people. In addition to output, investment also grows, ensuring that the capital stock responds to the greater supply of labour. The reform will boost purchasing power and increase consumption. A small part of the benefit of the reform will flow abroad via a deterioration of terms of trade.

In ETLA's baseline projection, the sustainability gap, calculated with a 100-year time horizon, will be reduced by 1.1 percentage points.

According to ETLA's model analysis, the impact of the pension reform will depend significantly on how attitudes relating to the supply of labour change as lifespans increase. Uncertainty is associated particularly with the unemployment path to retirement. The unemployment path to retirement will probably lengthen as a result of the reform, because it has not been agreed to raise the lower age limit for the unemployment path to retirement at the same pace as the lowest old-age pension age. Therefore there is a risk that the unemployment path to retirement will again become as significant a path away from working life as it was before the 2005 pension reform. If this happens, the impact of the pension reform on working careers will be significantly less than that sought. At the same time, the sustainability effects would weaken substantially. According to an alternative projection, the sustainability gap would be reduced by 0.6% of GDP. This impact assessment has been calculated for a baseline scenario in which employment develops to some extent more poorly than in the assessment of the Finnish Centre for Pensions. In the ETLA publication, various sensitivity analyses of the effects of the reform have also been made.

Impact assessments of the Bank of Finland

In a simulation made with the Bank of Finland's Aino model, the pension reform is taken into account by assuming that the reform will postpone the retirement age and change

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12 The publication is available (in Finnish) at the following address: https://www.etla.fi/wp-content/uploads/raportti_2015_1.pdf

pension replacement ratios in the manner projected by the Finnish Centre for Pensions.[13] In the simulation, it is found that the pension reform will reduce the need to raise the total tax rate by approximately 1.4 percentage points by 2040. This result is to some extent higher than in the estimate obtained in the mechanistic sustainability calculation, according to which the pension reform will reduce the general government sustainability gap by approximately one percentage point. Based on the Bank of Finland's simulation, the main macro effect arises from the fact that the increased labour supply and the reduced pressure to tighten taxation will curb growth in labour costs. This will improve price competitiveness, which will be evident in accelerating export growth. The easing of cost pressures will also be evident as a slowing of growth in public consumption. The employment rate will rise by approximately one percentage point. Despite the improvement in employment, growth of private consumption will be relatively modest. On the other hand, investment growth will accelerate and the capital stock will thereby expand more quickly. Overall, the positive effects of the pension reform on economic growth will be moderate. GDP growth would accelerate as a consequence of the pension reform by just under 0.1 percentage points compared with development according to the baseline scenario. After 25 years, GDP would be accordingly 1.7% greater as a result of the pension reform than in the baseline scenario.

Effects of the pension reform on the sustainability gap

A memorandum published by the Ministry of Finance on 26 September 2014 states that the pension reform will reduce the sustainability gap by approximately one percentage point. The reform will influence the sustainability gap in two ways. The first channel of influence runs via pension expenditure. The reform will reduce the level of public expenditure needed to pay for pensions and will therefore reduce the sustainability gap in this respect. The second channel of influence runs via employment directly to GDP. The reform will increase employment and therefore boost GDP. The impact on the sustainability gap that comes via pension expenditure as well as the overall impact are presented in the following table.

	Impact of pension expenditure	Overall impact
Sustainability gap	-0.6	-1.0

The pension reform will reduce pension expenditure by just over 0.6 percentage points in ratio to GDP, which will reduce the sustainability gap to the same extent. The impact is net, because there are some elements in the reform that lower and others that increase pension expenditure. The lowering impact comes from the accrual rule changes and from the shortening of the period spent in retirement. The increasing impact comes from improv-

[13] Bank of Finland Bulletin 5/2014. Publication is available (in Finnish) at: http://www.suomenpankki.fi/fi/julkaisut/euro_ja_talous/talouden_nakymat/Documents/ET514.pdf

ing the level of the average pension. The reduction of pension expenditure is assessed and reported in more detail by the Finnish Centre for Pensions.

The increase in employment arising from the reform will also reduce the sustainability gap otherwise than via reducing pension expenditure. The improvement in employment will increase total output. It is estimated that this other effect resulting from employment will be just over 0.3 percentage points in ratio to GDP. In the sustainability gap calculation, GDP growth will reduce age-related expenditure, because the share of GDP accounted for by expenditure on healthcare, long-term care, unemployment, pensions and education will fall. It is assumed that public expenditure other than age-related expenditure will increase at the GDP growth rate.

Unlike the assumptions of the annual sustainability gap calculations, growth of healthcare and long-term care age-related expenditure is, in these calculations, linked to growth in average pay, not the GDP per capita growth rate. This assumption reflects the fact it is not believed that the reform of the pension system will directly increase other healthcare and long-term care expenditure. If it were assumed that employment growth resulting from the reform of the pension system will also increase healthcare and long-term care expenditure, the effect on the sustainability gap would be slightly smaller.

The impact of the agreement on unemployment is difficult to assess. Employment will increase, because the old-age pension age will rise and participation in the labour force will increase accordingly. The labour force, on the other hand, includes both the employed and the unemployed. It is possible that both employment and unemployment will increase at the same time.

In the social partners' agreement on pension reform, the raising of the age limit for the unemployment path to retirement is conditional on reviews, specified in the agreement, to be carried out in 2019. The assumptions about unemployment made by the Finnish Centre for Pensions include, however, the effects of changes to the length of the unemployment path to retirement. The length of this path will change as the lower age limit of the path rises and through the raising of the old-age pension age. The unemployment assumption included in the Finnish Centre for Pensions' calculations is more moderate that behaviour-based model calculations published earlier. The assumption of the Ministry of Finance's calculations has been taken into account as such as changes in the employment and labour force participation rates. A larger impact on unemployment would reduce the impact of the reform on the sustainability gap and a smaller impact would increase it. The sustainability gap would therefore not be reduced as much if unemployment were to grow more than assumed and vice versa.

Short-term effects of the reform on public finances

The freezing of the pension contribution level at 24.4% for the period 2017–2019, agreed in connection with the pension reform agreement, will reduce the pension funds' surplus in the short term, because the pension reform's effect of slowing growth in pension expenditure growth will not be evident until the 2020s. Before the reform, it was estimated that pension contributions would have had to be increased from 2017 because, according to legislation, contributions must be at a level that safeguards the financing of pensions.

The table below estimates how much weaker public finances will be when contributions are not increased as estimated before the pension reform agreement in autumn 2014. Based on the results, the budgetary position of the earnings-related pension funds will be approximately 0.1% weaker in ratio to GDP in 2017, because the pension contribution is not at a level 0.3 percentage points higher. If one takes into account that pension contributions are tax-deductible, the impact at the level of general government finances is slightly smaller.

Table 2. Impact of the pension reform on the budgetary position of earnings-related pension funds 2017–2018

	2017	2018
Pension contribution level agreed in the pension agreement, per cent of wage bill	24.4	24.4
Finnish Centre for Pensions' estimate of sustainable pension contribution level before the pension agreement, per cent of wage bill	24.7	24.9
Difference, percentage points	-0.3	-0.5
Impact on budgetary position of earnings-related pension funds, % / GDP	**-0.09**	**-0.14**

APPENDIX 2: Competitiveness Pact

The social partners signed the Competitiveness Pact on 14 June 2016. The objective of the pact is to improve Finnish companies' price competitiveness and thereby increase exports and employment.

The pact extends annual working time by 24 hours, cuts public sector holiday bonuses, and reduces the employers' social security contributions, partly transferring them to be paid by employees. As part of the pact, existing collective agreements will be extended by one year without any pay increases. The pact will reduce the unit labour costs of production by approximately 4% (see Table 1 for more detail). In addition, the Government will support the pact with tax concessions.

Table 1. Impact of measures on unit labour costs

Measure	2017	2018	2019	2020
Extension of annual working time by 24 hours (coverage of pact 91%)	-1.4	-1.4	-1.4	-1.4
Cut of public sector holiday bonuses by 30%	0.0	0.0	0.0	0.0
Reduction of health insurance contribution of all employers	-0.8	-0.8	-0.8	-0.8
0.85 percentage points transfer of unemployment insurance contribution from employers to employees	-0.4	-0.7	-0.7	-0.7
1.2 percentage points transfer of earnings-related pension contribution from employers to employees	-0.2	-0.3	-0.7	-1.0
Total	**-2.7**	**-3.2**	**-3.6**	**-3.5**
Impact of zero agreement in 2017 on level of Index of Wage and Salary Earnings	-0.5	-0.5	-0.5	-0.5
All measures, total *	**-3.2**	**-3.7**	**-4.1**	**-4.0**

*Due to rounding. the figures do not necessarily add up.

Impact on employment

Taking the tax reductions into account, it is estimated that the Competitiveness Pact package may increase the number of people in employment by approximately 40,000 in the longer term. Great uncertainty it associated with the employment effects of the pact, however. Uncertainty is caused by the fact that the assessment concerns an extensive package the like of which has not been implemented before. In addition, the pact includes measures whose implementation timeframe is difficult to estimate in the absence of empirical data.

The calculations are based on the fact that the average productivity of the economy as a whole is assumed to develop in the same way in both the baseline scenario and in the scenario describing the effects of the package of measures. This means that the improvement in employment due to the reduction in the price of labour will also lead to the growth of GDP to the same extent. Therefore, when GDP grows to same extent as employment, the level of GDP would rise as a result of the pact by 1.5–2%. The calculations do not itemise how individual demand items, such as exports, investment and consumption, will develop.

By improving competitiveness, the goal, however, is a positive impact of exports and business investment.

A key assumption in terms of the results is the sensitivity of demand for labour to changes that take place in its price. Research conducted in recent years on the demand flexibility value suggests that the real wage flexibility of labour has increased. An obvious reason for the increase in flexibility is the deepening of economic integration, which has increased competition in the commodity markets and mobility of capital. In this context, an average flexibility for entrepreneurial activity of -0.7 has been used. For the calculation, flexibility of labour supply also plays a key role. In the analysis, the flexibility is assumed to be 0.3.

The overall impact of the package of measures will be partly mitigated by the fact that the increase in employees' social security contributions will reduce consumers' purchasing power at the level of 2020 by approximately EUR 400 million, taking the tax concessions into account. This will reduce economic activity to some extent via domestic demand. The impact on total output will be dampened, however, by the fact that part of the change in consumption will be transmitted via imports to outside the national economy. More moderate inflation together with improved employment will also support the development of purchasing power.

The Competitiveness Pact covers over 90% of wage earners. In calculating the employment impact, the assumption has been made, however, that contractual pay increases in sectors outside the pact will be zero in 2017. In the calculations, it has also been assumed that, due to the high unemployment at the starting situation, there will be no wage reaction to any great extent.

In addition to direct measures affecting unit labour costs, the social partners agreed in connection with the Competitiveness Pact on the expansion of opportunities for local agreement and outlined that in the future the so-called Finnish model will be adhered to in wage-setting. In the Finnish model, the cost level of the next negotiation rounds will be based, as a rule, on the benchmark of internationally exposed export sectors. The model is a permanent, open-ended policy, not only a policy for the next pay negotiation round.

The calculations do not include an assessment of the effects of promoting local agreement and introducing the Finnish model, because they are difficult to assess quantitatively. It is probable, however, that the measures will support competitiveness, exports, economic growth and at the same time the sustainability of public finances.

An independent forecast by the Economics Department of the Ministry of Finance, based on the Government's budget proposal, states that the employment effects will depend to a large extent on how Finland's labour costs develop in relation to competitor countries after 2017 and also more generally on international economic development. The current weak demand prevailing in the international economy, particularly with respect to investment goods, will slow the implementation of positive effects in the short term. It is therefore unlikely that all of the positive effects will materialise as quickly as labour costs are reduced.

The forecast assumes that the reduction in labour costs will not yet increase employment in 2017. In 2018 the favourable impact of the pact on labour demand will begin to be evident, employment growth will pick up and will also continue in 2019–2020. In 2017–2020, the number of people in employment will increase by a total of 46,000. The Competitiveness

Pact will contribute to the positive development of employment. A more positive development of employment than forecast is, however, possible as a result of the pact.

Impact on public finances

The Competitiveness Pact includes measures that both strengthen and weaken public finances. If the pact increases employment as expected and if central and local government are able to take full advantage of the savings potential created by the extension of working hours, the impact of the pact on public finances will be neutral in the long term. In other words, a significant part of the room for manoeuvre brought to public finances by the pact will be used to lower Finland's comparatively total tax rate, which in turn will create opportunities to boost economic activity. It should also be noted that the assessment does not include the difficult-to-estimate positive effects on public finances of promoting local agreement and introducing the Finnish model.

An independent forecast by the Economics Department of the Ministry of Finance, based on the Government's budget proposal, states that the Competitiveness Pact is expected to weaken the budgetary position of general government finances by EUR 1.2 billion, i.e. 0.55% in ratio to GDP, in 2017. The short-term costs of the pact are therefore significant. There follows a more detailed account of how the impact of the Competitiveness Pact on general government finances has been taken into account in the forecast that is the basis of the Government's budget proposal.

The Competitiveness Pact and the tax reductions associated with it will weaken the budgetary position of general government finances in 2017–2019 by slightly more than one billion euros and from 2020 onwards by just over EUR 800 million, excluding the positive effects of increased employment. Increasing employment by 40,000 people would strengthen the budgetary position of general government finances by approximately EUR 850 million in the longer term.

The Competitiveness Pact will reduce general government revenue in the short term. The pact will cut the combined social insurance contributions paid by employers and employees, and will ease direct taxation. In the short term, the pact will also curb growth of wages and the taxes and payments levied on them. The change of income distribution in favour of companies will increase the taxes paid by companies on their profits.

On the other hand, the pact will also reduce general government operating expenditure, as general government's indirect costs as an employer will be lower, public sector holiday bonuses will be cut and wages will not be increased. The pact will also reduce the public sector's need for labour in the longer term.

Table 2 presents an estimate of the impact of the Competitiveness Pact on the budgetary position of general government finances.

Table 2: Annual impact of the Competitiveness Pact on general government finances, net for each measure, EUR million.

Measure	2017	2018	2019	2020	Longer term
Extension of annual working time by 24 hours	50	100	120	140	140
Cut of public sector holiday bonuses by 30%	150	150	150	0	0
Reduction of health insurance contribution of all employers	-470	-500	-530	-300	-300
Partial transfer of earnings-related and unemployment insurance contributions from employers to employees	10	20	30	40	40
Impact of internal transfer of employees' health insurance contributions via taxation	-400	-320	-290	-150	-150
Active tax reductions in 2017	-540	-550	-560	-570	-570
Total impact	**-1200**	**-1100**	**-1080**	**-840**	**-840**
Impact via growth in economic activity*					850
Total impact in the longer term					10

* The precise timing of effects cannot be reliably assessed.

The extension of annual working time by 24 hours will have no direct impact on general government finances. The extension of working time will, however, reduce the need for labour and create the opportunity to make a net saving of approximately EUR 140 million in public finances. Attaining the saving will require that the both central and local government decide separately to take advantage of this opportunity. In the forecast for central and local government, the notional saving arising from the extension of working time has been assumed to materialise gradually by 2020, taking into account, however, that the extension of working hours will not produce a saving in the education sector.

The pact will reduce the employers' health insurance contribution by approximately one percentage point in 2017–2019. The reduction will weaken general government finances by approximately EUR 500 million per year. From 2020, the contribution reduction will be approximately 0.6 percentage points and the weakening effect on general government finances will fall to approximately EUR 300 million. In 2017–2019, some of the measures will be funded by temporarily cutting public sector holiday bonuses by 30%.

The partial transfer of pension and unemployment insurance contributions from employers to payment by employees will ease companies' and tighten employees' taxation by just over EUR 300 million in 2017, and the impact will grow to approximately EUR 1.1 billion by 2020. The measure will not, however, have a substantial impact on the budgetary position of general government finances.

The internal transfers made for technical reasons to employees' health insurance contributions will ease employees' taxation by an average of just over EUR 300 million in the period 2017–2019, but the impact will be halved from 2020. In addition, the Government will support the pact by easing employees' and pensioners' taxation by a total of just over EUR 500 million in 2017.

APPENDIX 3: Justifications for activating the investment clause

According to a communication published by the European Commission on 13 January 2015[14], certain investments that are co-financed by the EU may be interpreted as increasing longer-term growth potential, and they may entitle a Member State to deviate from the medium-term objective or the adjustment path towards it. The activation of the investment clause requires that

i) GDP growth is negative or the output gap is at least -1.5% in ratio to GDP;
ii) the deviation from the MTO or the agreed adjustment path towards it does not lead to an excess over the reference value of GDP deficit and an appropriate safety margin is preserved;
iii) subject to a maximum deviation of 0.5% of GDP from the adjustment path towards the MTO, the deviation is equal to national share of expenditure in EFSF projects, for example;
iv) the cumulative temporary deviation from the adjustment path to the MTO granted under the structural reform and investment clauses does not exceed 0.75 % of GDP;
v) co-financed project expenditure should not substitute for nationally financed investments, i.e. general government fixed capital formation in the year in question must not decrease;
vi) the Member State must compensate for any temporary deviation from the adjustment path to the MTO, and the MTO must be reached within the four-year horizon of its current Stability or Convergence Programme; and
vii) once the Member State has benefitted completely from the temporary deviation from the MTO (a maximum of 0.5% of GDP) facilitated by the investment clause, it is not allowed to benefit again from the investment clause until it has attained its MTO.

Excluding a couple of exceptions, the conditions for utilising the structural reform clause and the investment clause have mainly the same conditions. Broadly speaking, Finland also meets the main conditions for utilising the investment clause. The specific conditions for utilising the investment clause are met: firstly, according to a Ministry of Finance forecast, Finland's output gap will be -1.7% in ratio to GDP in 2017. In addition, general government investments will increase by approximately 0.6% in real terms in 2017. With respect to the common conditions for utilising the clauses, it can be stated that the general government deficit will remain below the reference value by a clear margin, even though the so-called safety margin conditions will not be met in the light of current knowledge. The Finnish Government aims to achieve the medium-term objective in 2019.

Finland's financing contribution from 2017 grant authorisations to EU Structural Fund, external border cooperation and other cohesion policy programmes will be EUR 175.1 million, i.e. approximately 0.1% in ratio to GDP.

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14 See Vade Mecum On The Stability and Growth Pact 2016, http://ec.europa.eu/economy_finance/publications/eeip/pdf/ip021_en.pdf pages 218–223.

APPENDIX 4: Methodological aspects

The macro forecast is based on the views of experts, the Ministry of Finance DSGE model (see e.g. Economic Survey, spring 2014, p. 18, and Economic Survey, autumn 2016, p. 18), a short-term factor model and various partial models.

The forecast for general government finances is based on, among other things, a short-term 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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