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Lausunto

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Finanssipoliittisen parlamentaarisen työryhmän avoin kuuleminen julkisen talouden vahvistamisesta, kasvupolitiikasta ja velkakestävyydestä

Lausunnonantajan lausunto

Voitte kirjoittaa lausuntonne alla olevaan tekstikenttään

Thank you to the parliamentary working group on fiscal policy for requesting my statement. Since, unfortunately, my Finnish skills are not yet sufficient to adequately formulate my answers in Finnish, I write my comments in English for the purpose for clarity. Please feel free to contact me if you have further questions.

Over the past decade — and especially in recent years — Finland’s public debt has risen considerably relative to the size of the economy. The debt level is now well above the reference value used in the EU fiscal rules, which reduces Finland's ability to respond to future economic shocks and may gradually increase borrowing costs. Although Finland still benefits from relatively favorable borrowing conditions compared to many countries, recent credit-rating developments and continuing large fiscal deficits raise legitimate concerns about the long-term sustainability of public finances.

In the following, referring to the three questions formulated by the Parliamentary Working Group on Fiscal policy, I will

1. Explain briefly why fiscal adjustment is economically important in the current situation.

2. Provide considerations for setting fiscal position targets for the period 2027–2033, including the last year of the next parliamentary cycle (2031); and

3. Discuss policy measures that can support sustainable adjustment while allowing for economic growth and conclude from international experience, including the German debt brake.

1. Why Fiscal Adjustment Is Important Now

Finland’s fiscal trajectory with persistently high deficits would be concerning even without the EU fiscal rules, which require countries with high deficits and rising debt to implement consolidation.

a. High and Persistent Deficits Increase Debt Rapidly

When the government runs high deficits year after year — particularly during periods of modest growth — debt rises faster than the economy can compensate. Over time, this erodes fiscal space, meaning the government has less capacity to respond to unexpected shocks via additional borrowing. Sustainable public finances require that it can be expected that the nominal government debt level relative to the nominal gross domestic product moves towards a stable long-term level. (The exact size of such a debt level depends on multiple factors and is not necessarily constant over time.)

b. Rising Debt Can Undermine Market Confidence

A high debt ratio does not automatically cause a crisis. However, when combined with weak growth prospects or political uncertainty, it can lead investors to question the country’s ability or willingness to manage its debt over the long term. This may translate into higher borrowing costs. Thus, with increasing indebtedness, there is an increased risk for an uncontrolled increase in borrowing costs and indebtedness as well as an increased probability of a situation, in which creditors are not willing to provide new credit to the government anymore. Such a debt crisis, which may result in a default, would require strong austerity policies such as, for instance, in Southern Europe during the European sovereign debt crisis. Concluding, during good times and after a crisis with extended budget deficit, fiscal consolidation should be used to reduce the debt to GDP level.

c. Limited Fiscal Space Restricts Crisis Response

The experience of crises such as COVID-19 showed that governments need fiscal room to respond quickly and decisively. When debt is already high, future crises — economic, geopolitical, or related to ageing populations — become harder to manage. This applies also to long-term needs such as defence, climate adaptation, or digital transformation.

d. Demographics and Structural Factors Increase Long-Term Pressure

Finland’s ageing population will require increased pension, healthcare, and care-service spending. At the same time, the working-age population is not growing at the pace required to support the rising costs unless net migration increases. These trends make it even more important to secure the sustainability of the public finances.

e. A Remark on the Debt Financing Structure

Finally, the structure of the existing debt matters. A high debt level becomes more vulnerable to interest rate increases when a large share of bonds must be refinanced in the near future. Longer-maturity bonds reduce this vulnerability, although they often carry slightly higher interest rates. It may therefore be useful to review whether the current maturity structure adequately protects Finland against sudden increases in global interest rates.

2. Considerations for Fiscal Targets for 2027–2033 and for 2031

The first two questions of the Parliamentary Working Group on Fiscal Policy concern the pace and level of fiscal adjustment over the medium term. These questions are closely linked, because the credibility of the overall consolidation plan depends both on having a coherent multi-year strategy and on setting realistic year-by-year milestones.

a. The Importance of a Credible Medium-Term Plan

Fiscal policy affects expectations among households, firms, and investors. A clear and predictable plan reduces uncertainty and supports confidence. This requires:

- a transparent timeline.
- realistic and consistent targets.
- stability across political cycles.
- and careful communication to the public and to markets.

If the government fails to reduce uncertainty, the economy typically suffers: households and firms postpone consumption and investment, and investors may become more reluctant to hold Finnish government debt. Importantly, even the expectation of future consolidation — when the exact measures remain unclear — can reduce economic activity if uncertainty is high. It can be very well assumed that such uncertainty in the light of the frequent news about the high public deficit contribute substantially also to the current difficulties of the Finnish economy.

b. Balancing Ambition with Realism

Targets must be ambitious enough to restore a stable debt path, yet realistic enough to be achieved. Overly strict targets risk being missed, damaging credibility and increasing uncertainty. Targets that are too weak, on the other hand, may not reassure investors or address long-term vulnerabilities, potentially leading to higher borrowing costs or credit-rating downgrades. In practice, a moderate but steady consolidation path tends to be the most credible.

c. Timing Matters

The choice of the timing of fiscal consolidation is subject to trade-offs. There are advantages to a somewhat front-loaded adjustment strategy: starting consolidation earlier helps slow debt accumulation and signals commitment to sustainability. However, the pace should not be so rapid that it harms economic growth or disrupts key public services. Early fiscal measures are most effective when combined with structural reforms, whose benefits tend to appear gradually.

In times of acute crisis, a back-loaded approach may be appropriate. But the current situation does not appear to reflect only temporary shocks. The geopolitical environment — especially the consequences of Russia's invasion of Ukraine — and ongoing global trade disruptions are likely to persist. These long-lasting challenges mean that crisis-related arguments for delaying consolidation are less compelling. Instead, the current high deficit itself creates uncertainty about future tax and spending measures, and well-designed consolidation may therefore support investment and consumer confidence.

d. Consistency During Election Years

International experience shows that fiscal discipline often weakens ahead of elections. For Finland to maintain credibility, the consolidation path should be adhered to throughout the political cycle, including during the run-up to elections (i.e. in 2027 and in 2031 as well as the years right before). Stable fiscal policy across cycles is an important signal of reliability to both domestic and international audiences. To my understanding, the new fiscal framework addresses this issue via the decision power of the parliamentary working group on fiscal policy. However, consistency matters also regarding the priority of government spending categories. Specifically, it is important to monitor the trade-off between future-oriented public spending and public consumption, where the impact of the latter tends to affect voters earlier and may, thus, be considered politically more sensitive.

3. Measures to Support Adjustment While Safeguarding Growth

a. Protecting Growth-Enhancing Investments

Long-term economic growth relies on future-oriented public spending — particularly education, research and innovation, digital infrastructure, and skill development. Fiscal consolidation should therefore avoid allowing these categories to decline in real terms or relative to GDP. If they do, the quality of public services and future productivity may deteriorate.

Given the structural nature of Finland's deficit, consolidation efforts should focus primarily on areas of public consumption rather than on reducing investment.

b. Improving Spending Efficiency

Consolidation does not need to rely solely on spending cuts; improving the efficiency of existing expenditures can yield substantial gains. Key opportunities include:

- simplifying administrative structures and reducing overlaps between central and local governments;
- improving procurement practices, for example by increasing supply competition or centralizing procurement expertise;
- targeting social transfers more effectively and reducing leakage to non-priority groups.

Even in growth-enhancing sectors, efficiency reviews can be beneficial. For example:

- assessing whether new infrastructure projects create long-term maintenance liabilities that outweigh their benefits;
- reviewing higher-education financing models that focus heavily on quantitative output indicators and may unintentionally undermine quality;
- adjusting study-place allocation to address labor shortages, such as increasing medical school places to ease the shortage of physicians.

c. Strengthening the Revenue Base

A sustainable fiscal path requires a stable revenue base. This can be supported by:

- broadening tax bases;
- closing loopholes;
- reducing inefficient tax expenditures.

The economic impact of tax reforms depends on which tax instruments are adjusted and how the changes affect income distribution and work incentives. A strategic review of tax expenditures can help identify areas where revenues can be strengthened without impairing growth.

d. Structural Reforms to Support Growth

Structural reforms can increase the economy's long-run growth potential and help stabilize public finances. Key areas include:

- policies that increase labor force participation;
- measures that enhance productivity;

- reforms that reduce barriers to innovation;

- strengthening competition and reducing direct and indirect company subsidies that distort markets.

Higher long-term growth makes fiscal sustainability easier and lowers the required pace of future consolidation.

e. Improved targeting of social welfare and crisis policies

Better targeting does not necessarily reduce total spending but helps ensure that limited fiscal resources achieve the highest impact. Finland’s extensive administrative data (including tax and income registers) makes it possible to evaluate the effectiveness of welfare programs and to identify targeting improvements.

For crisis-response mechanisms — such as the support measures deployed during COVID-19 — improved targeting could reduce the fiscal cost of future crises by preventing overspending on groups that do not require assistance.

f. Lessons from Debt-Rule Experiences Abroad, especially the German Debt Brake

Experiences from countries with strict fiscal rules, such as Germany, show that well-designed fiscal frameworks can support long-term budget discipline. However, they also highlight an important risk: if rules focus too narrowly on annual deficits, governments may cut public investment instead of politically more sensitive current expenditures. Such a policy can substantially reduce the growth prospects of the economy and reduce the fiscal space also for such politically more sensitive expenditures in the long run.

Under-investment is not caused by fiscal rules alone, but political incentives often favor protecting current spending over investments whose benefits materialize later. Thus, despite the new fiscal framework, Finland needs to monitor critically other aspects of fiscal policy beyond deficit and debt level. For example, it should be considered essential to maintain education or defence investment above a specified share of GDP.

Given the magnitude of Finland’s required adjustment, small across-the-board cuts are unlikely to succeed. Some choices will inevitably involve prioritizing certain services over others. This underlines the need for a broad societal discussion about which public services should remain protected and which areas could be reduced while preserving long-term growth capacity.

Conclusion

Finland’s fiscal outlook is challenging but manageable. A credible, sustained, and well-communicated consolidation plan — combined with reforms that support long-term growth — can restore fiscal sustainability without undermining living standards or social cohesion.

Clear and consistent fiscal targets for 2027–2033, including a credible milestone in 2031, will help reduce uncertainty, support investment, and strengthen market confidence. Successful consolidation will require a balanced approach: steady deficit reduction, protection of growth-enhancing spending, and a willingness to prioritize among public services. With such a strategy, Finland can rebuild fiscal resilience and ensure that the public finances remain robust in the face of demographic, geopolitical, and economic challenges.

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