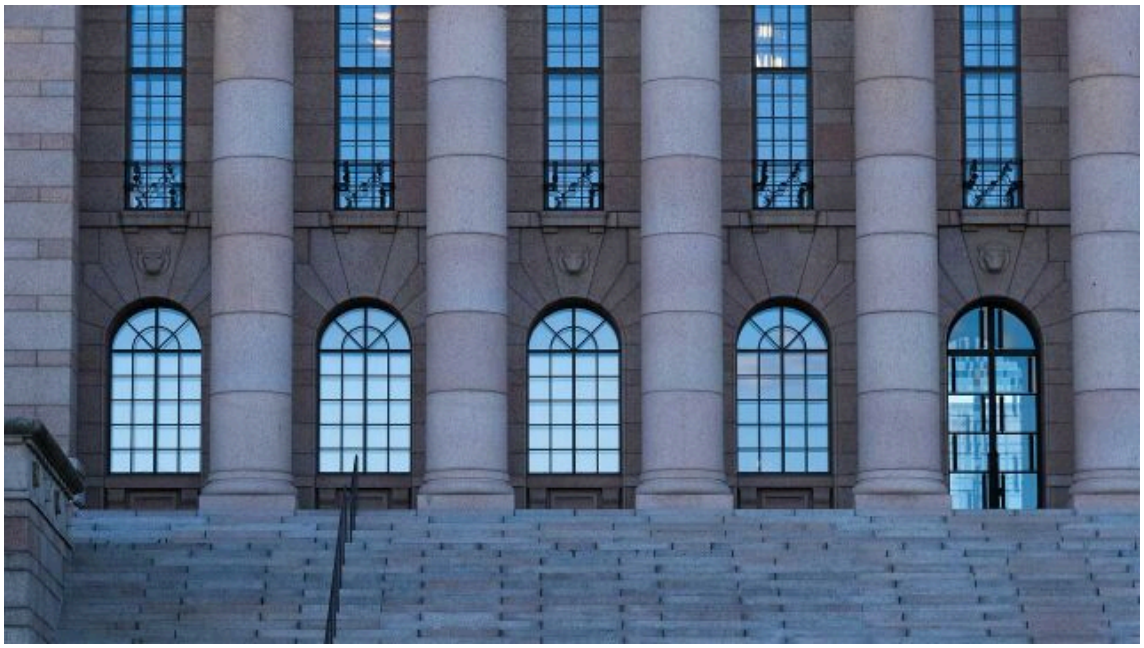
Assessment of public finances: From targets to actions

Finnish economy | 21 January 2026

The level of general government debt in Finland will continue to rise in the immediate years ahead. Policymakers, in their determination of fiscal consolidation measures, will be guided in the coming years by the Finnish legislation on a national fiscal framework and by the EU's fiscal rules, but expenditure pressures will make this difficult in conditions of subdued economic growth. Sustained efforts will nevertheless produce results if resolute action is taken to achieve the targets while strengthening the economy's growth potential.



Current state of Finland's public finances and the outlook

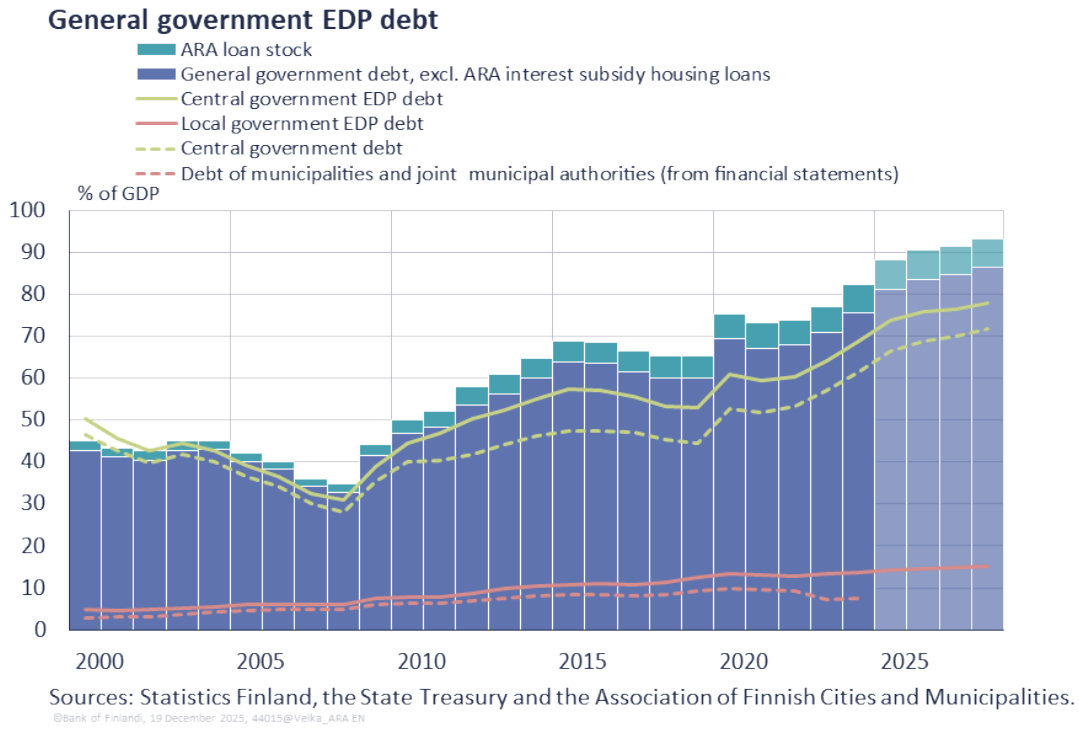
General government debt continues to grow. The ratio of general government debt to gross domestic product (GDP) for 2025 will be up by more than 5 percentage points, which was also the case in 2024. According to the Bank of Finland's forecast, the debt ratio at the end of 2025 will be 88% and this will grow by a further 5 percentage points by the end of 2028. The growth in the debt ratio in 2025 has been accelerated especially by one-off factors and weak GDP growth. The negative primary balance[1] will have a greater impact in 2026 and, together with rising interest expenditure, it will increase the debt ratio by 1 to 2 percentage points annually in the period

2026–2028.

Central government's nominal debt relative to GDP will rise higher in the forecast years than during the recession of the 1990s. It will grow to 66.4% of GDP in 2025, compared with its 1996 high of 64.8%, and will exceed 71% in 2028. In addition, the public debt of municipalities and joint municipal authorities has grown considerably since the mid-1990s: according to financial statements, their debt relative to GDP has increased 2.5-fold since 2000, and, in the EU context, the EDP debt[2] of local government is 14% of GDP. The legal obligation of municipalities to cover their accumulated deficits within a four-year period has not prevented the rise in municipal debt because investments have been systematically higher than depreciation.

Overall, general government EDP debt will increase to more than 90% of GDP as early as 2026. ARA interest subsidy housing loan liabilities are currently raising the recorded EDP debt by about 7 percentage points, though this does not alter the general picture of the debt path. By 2028, the debt ratio will rise to 93% (Chart 1).

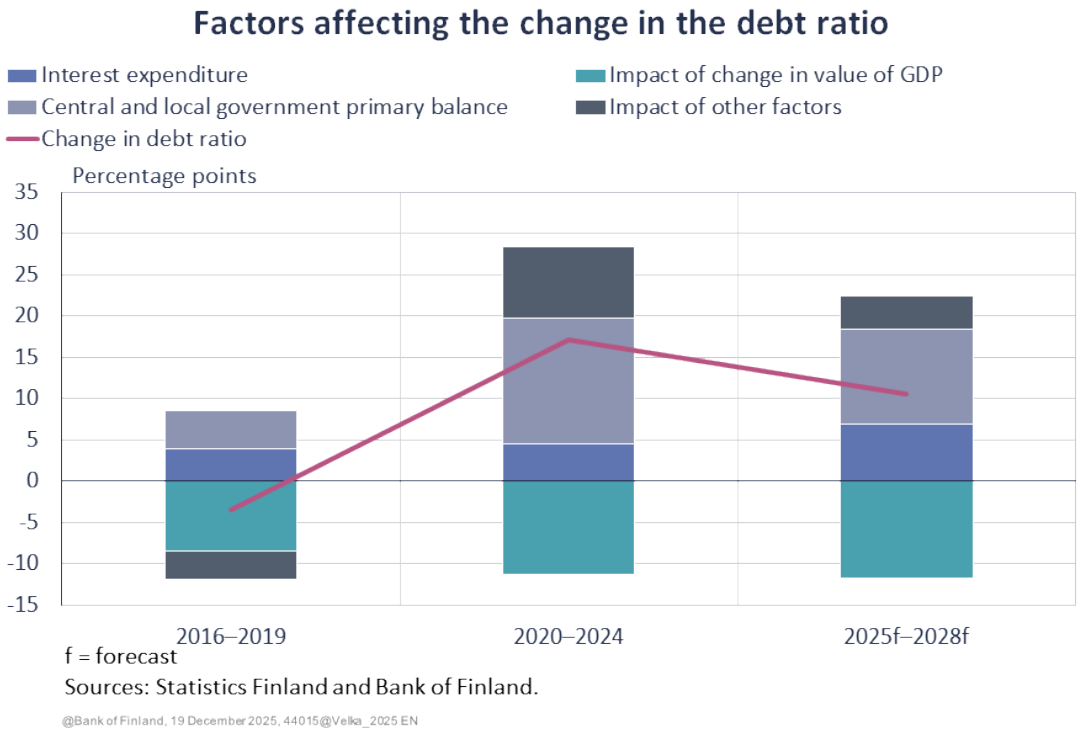
Chart 1.



In the coming years, the general government debt ratio will be pushed up by the large primary deficits of central and local government and rising interest expenditure, which will have to be financed with new debt. In forward-looking debt sustainability analyses, it is important to keep separate the net lending of earnings-related pension providers, because the surpluses of these

pension providers cannot be used to repay debt, even though they are included in the general government sector's net lending. Growth in the ARA interest subsidy housing loan stock, on the other hand, is not taken into account in medium and long-term scenarios of debt dynamics. Growth in nominal GDP will slow the growth of the debt ratio in 2025–2028 (Chart 2).

Chart 2.



For the time being, Finland's general government debt still has a good credit rating, although in summer 2025 the credit rating agency Fitch Ratings downgraded Finland to the third-best rating, 'AA'. However, the increase in debt relative to GDP elevates the risks associated with acquiring finance, especially in the context of broader market turbulence. The annual gross financing need for central government is currently around 15% of GDP, while the threshold indicating increased risk in debt sustainability analyses of advanced economies is considered to be 20%. If the annual borrowing of Municipality Finance Plc is included, the gross financing need for general government in Finland rises to 18% of GDP. In addition, by comparison with other European countries, central government has relatively large contingent liabilities, which are derived from, among other things, the state guarantee for export credits. The debt sustainability analyses of international institutions also take account of these as well as a wide range of other indicators related to debt sustainability.

Factors contributing to changes in the general government debt ratio

There are four main factors contributing to changes in the general government debt-to-GDP ratio: GDP growth, the implicit interest rate on debt, the primary balance relative to GDP, and so-called stock-flow adjustments.[3]

The implicit interest rate is obtained by dividing interest expenditure by the debt stock. The primary balance refers to net lending excluding interest expenditure.

If two of the factors are combined to make an interest–growth factor, the change in the debt ratio will depend on three variables. The interest–growth factor describes the relationship between the implicit interest rate and economic growth: if the interest rate exceeds the growth rate, the debt ratio will increase even if the primary balance is in equilibrium, and if the growth rate exceeds the interest rate, the debt ratio will decrease over time.

The primary balance relative to GDP directly affects the debt ratio: a surplus reduces debt, and a deficit increases it. The stock-flow adjustments take account of other factors, such as the acquisition of financial assets, timing differences and imputed items, which are not National Accounts expenditure or revenue but which do affect debt.

The black symbols indicate the annual change in the debt ratio. The coloured bars show the components of changes in the debt ratio, where the sum of these is the net change. See Footnote 3.

The interest–growth factor reduced the debt ratio or slowed its growth in 2010–2011, 2015–2019 and 2021–2023 (Chart 3). According to the Bank of Finland's December 2025 forecast, the interest–growth differential will again have a slowing effect in the years 2025–2028, although this will be slight in 2025. Implicit interest rates are still low but are gradually rising as the debt stock increases and is renewed in a higher market rate environment.

The stock-flow adjustments have been positive in all other years except 2016, 2018 and 2021, when the debt ratio did not increase either. Positive adjustments have been large and have significantly accelerated the growth of the debt ratio. A high proportion of the

stock-flow adjustments are explained by the surplus of the social security funds, and in particular of the earnings-related pension providers, which has strengthened the general government primary balance while partly covering the deficit of central and local government. Although the surplus produces a positive correction, the corresponding increase in debt is still essentially due to the primary deficit of central and local government, the impact of which is thus reflected in two different factors.

There are also other reasons for the rising debt. For example, in 2020 the stock-flow adjustments were boosted by the growth of central government cash reserves and in 2022 by the increase in cash collateral provided in connection with derivative contracts.

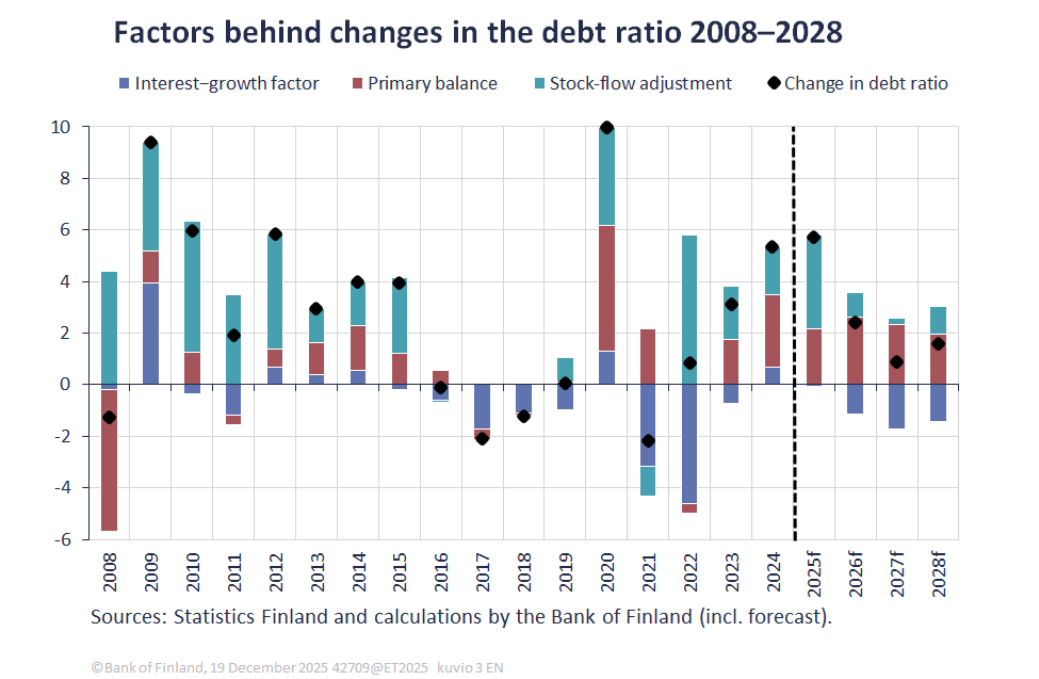
During the period 2008–2024, general government net lending was positive only in 2008. Since then, the primary balance has not been large enough to cover debt interest payments, and general government finances have been in continuous deficit for 16 years. During this time, the debt ratio has grown by more than 46 percentage points.

A general government deficit in a single year does not automatically signify an increase in the debt ratio. But if the primary balance has been negative, the debt ratio will generally also have increased in those years (Chart 4). Also, the more negative the primary balance, the more the debt ratio will have increased on average.

The chart shows the primary balance and the change in the debt ratio between 2008 and 2028. The horizontal axis shows the general government primary balance relative to GDP, and the vertical axis shows the change in the debt ratio in the corresponding year.

A positive primary balance has not always been enough to reduce the debt ratio. The debt ratio grew with a positive primary balance in 2011 and 2022, due to large stock-flow adjustments. On the other hand, the debt ratio decreased with a negative primary balance in 2016 and 2021, when the interest–growth factor and stock-flow adjustments were favourable. In recent years, stock-flow adjustments have increased as a result of advance payments for the fighter aircraft procurement, among other things.

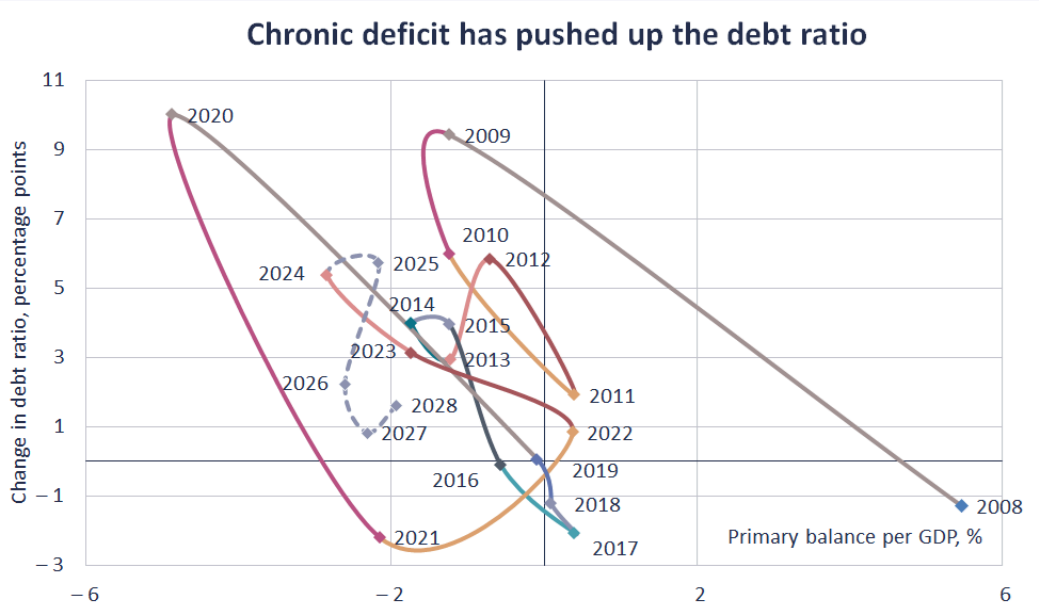
Chart 3.



Sources: Statistics Finland and calculations by the Bank of Finland (incl. forecast).

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Chart 4.



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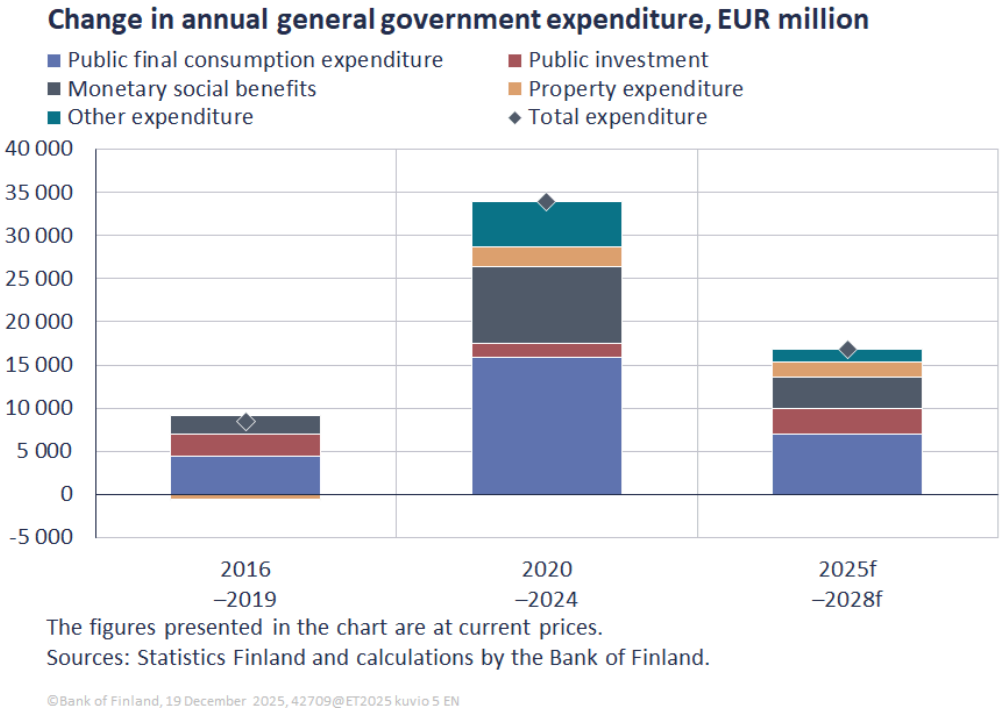
What causes debt to grow?

The growing debt has been caused mainly by the chronic deficit of central and local government. In the period 2016–2024, the expenditure item at current prices that grew most in euros was public final consumption expenditure, which mainly consists of personnel expenditure and consumption of intermediate products minus charges received from services (Chart 5). Final consumption expenditure accounted for almost half of the overall increase in public spending.

Monetary social benefits also increased significantly, accounting for more than one third of the expenditure increase. Public investment and other expenditure each accounted for about one tenth of the increase in total expenditure, while debt interest payments only accounted for 2%. Other expenditure includes subsidies and current transfers paid to businesses, organisations and farmers.

The growth shares of the expenditure categories in 2016–2024 correspond mainly to their share of the total expenditure, but social benefits have increased more moderately than other expenditure.

Chart 5.



Public final consumption expenditure and social benefits paid have increased because of population ageing. At the same time, wage increases and higher prices for intermediate products

and outsourced services, as well as the index-linking of benefits, have increased expenditure annually.

In the period 2016–2024, more than 70% of the increase in final consumption expenditure came from local government and about one fifth from central government. The start-up of the operations of the wellbeing services counties in 2023 increased public consumption by an exceptional amount due to wage and price increases, the costs of making the changes involved, and the difficulties in determining the levels of expenditure transferred from the municipalities.

The growth in social benefits in the period 2016–2024 was mainly attributable to earnings-related pensions, whose index increases were exceptionally high in 2023–2024 due to inflation soaring in previous years. The growth of non-pension benefits, on the other hand, remained low. These other benefits are subject to index freezing and other cuts from 2024 onwards.

In addition to the impact of an ageing population, expenditure growth has also been boosted by the economic downswing and exceptional crises. The COVID-19 pandemic significantly increased spending on healthcare and unemployment security. Responses to the crisis also included substantial business subsidies, and since the pandemic, subsidies and current transfers have remained higher than in the pre-pandemic period. The energy crisis and inflation which followed the Russian invasion of Ukraine led to temporary support measures for households and businesses, and general government debt interest payments were pushed up by rising interest rates.

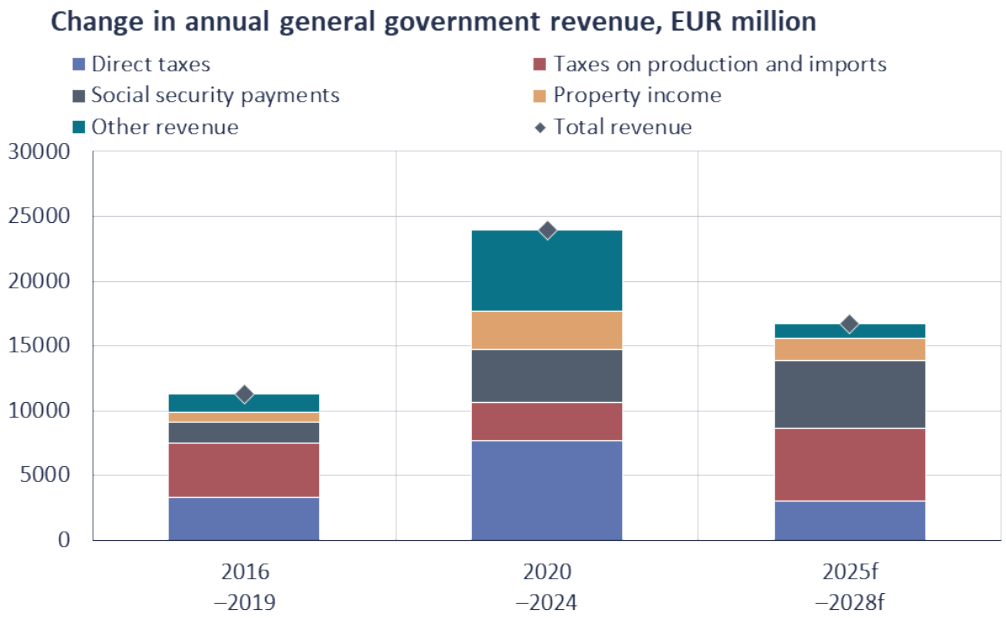
The growth in expenditure will slow down in 2025–2028 due to cost-saving measures. In 2025, the volume of public consumption will decline by an exceptional amount. Wage increases in 2026–2028 will sustain nominal growth in public consumption, although the volume will remain almost unchanged. Cuts will also moderate social benefits and reduce current transfers to domestic organisations and for international cooperation. Public investment, on the other hand, will increase significantly from 2026 onwards. This is when the delivery of fighter aircraft and vessels as part of major defence procurements will commence.

The category of government revenue that grew most in euros at current prices in 2016–2024 was direct taxes, in the form of taxes based on income and wealth (Chart 6). These accounted for slightly less than one third of the growth in overall revenue. The next largest increases were in taxes on production and imports, and other revenue, each accounting for about one fifth. Taxes on production and imports include VAT and excise duties, and other revenue consists mainly of sales and customer charges, as well as output for own final use.[4]

Social security contributions accounted for one sixth of the increase in revenue. The reduction in

the unemployment insurance contribution for 2024 reduced overall revenue. Property income accounted for about one tenth of the growth. In the overall growth, other revenue was overrepresented compared to its share of the total revenue, while direct taxes and taxes on production and imports were somewhat underrepresented.

Chart 6.



The figures presented in the chart are at current prices.
Sources: Statistics Finland and calculations by the Bank of Finland.
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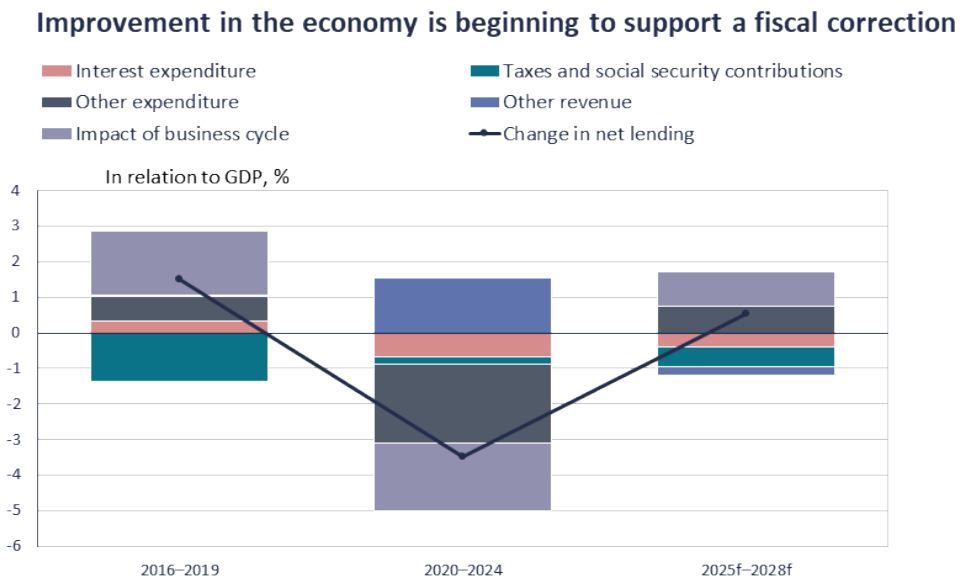
In the period 2016–2022, about 60% of the increase in direct taxes and more than 90% of the increase in taxes on production and imports concerned central government, and the rest related to local government. In 2023, part of the municipal income tax rate was transferred to central government after funding for the wellbeing services counties was commenced. Social security contributions received by earnings-related pension providers increased in the period 2016–2024, while those received by other social security funds decreased. Half of the increase in public sector entities' property income was that of earnings-related pension providers.

General government revenue at current prices grew by EUR 35 billion in total in the period 2016–2024, and corresponding expenditure by EUR 42 billion. In the pandemic year 2020, tax revenue diminished slightly, but it grew substantially in 2021 and 2022. However, the revenue growth was not sufficient to cover the rapid expenditure growth, and the deficit relative to GDP increased (Chart 7).

General government net lending was close to balance in 2017–2019 and 2022. After 2022, the

war in Ukraine, the energy crisis, inflation and the rise in interest rates weakened the economy and again widened the deficit. On the other hand, the rise in interest rates also boosted interest income for public sector entities. Net lending eventually declined to -4.4% of GDP in 2024.

Chart 7.



f = forecast
Sources: Statistics Finland and calculations by the Bank of Finland.

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According to the Bank of Finland's December 2025 forecast, weak cyclical conditions have kept tax revenue growth muted in 2025. However, even moderate revenue growth will suffice to reduce the deficit this year. In 2026–2027, tax cuts will limit the growth in direct taxation, but a recovery in private consumption will increase the accumulation of VAT. Property income growth is slowing down. Although the cyclical improvement is starting to support a fiscal correction, net lending in euros will not improve much in 2027–2028.

Difficulty setting a fiscal stance appropriate for the cyclical conditions

The current Government Programme, published in 2023, outlined expenditure adjustments totalling over EUR 4 billion. Less than a quarter of this, or EUR 0.9 billion, was expected to be achieved via the wellbeing services counties' own expenditure adjustments. The measures were planned to have the greatest impact in 2024 and 2027. To counterbalance these measures, the Government planned a fixed-term investment programme of EUR 4.5 billion, to be financed mainly

through revenue generated by the sale of government assets.

The Government has annually revised and supplemented its fiscal policy measures. In spring 2024, it decided on additional fiscal consolidation measures of EUR 1.4 billion, the majority of which concerned 2025. In its spring 2025 mid-term policy review, the Government decided to introduce a set of new measures that focus not on fiscal consolidation but on strengthening the preconditions for economic growth and on investment in security. In the autumn 2025 government budget session, the Government decided on a further sum of about EUR 1 billion of new measures, with the aim of stabilising the debt ratio at least for the years 2026–2027.

The Government's tax decisions (General Government Fiscal Plan for 2026–2029, p. 71) have increased taxation especially in the years 2024–2025, due to the increase in the general value-added tax rate, but in the years following this the direct net impact of the changes in taxation will turn negative from the perspective of central government finances. The lowering of labour taxation in 2026 and 2027 and the lowering of corporate income tax in 2027 will reduce tax revenue in static terms by approximately EUR 2 billion. As a result, across the parliamentary term as a whole, taxation policy will weaken the fiscal balance slightly. Public revenue will also be affected by changes in social security contributions, particularly the reduction in the unemployment insurance contribution in 2024 and the forthcoming increase in 2026. Based on the economic forecast, the tax-to-GDP ratio will be 41.8% in 2027, or approximately one percentage point lower than the average for the previous parliamentary term.

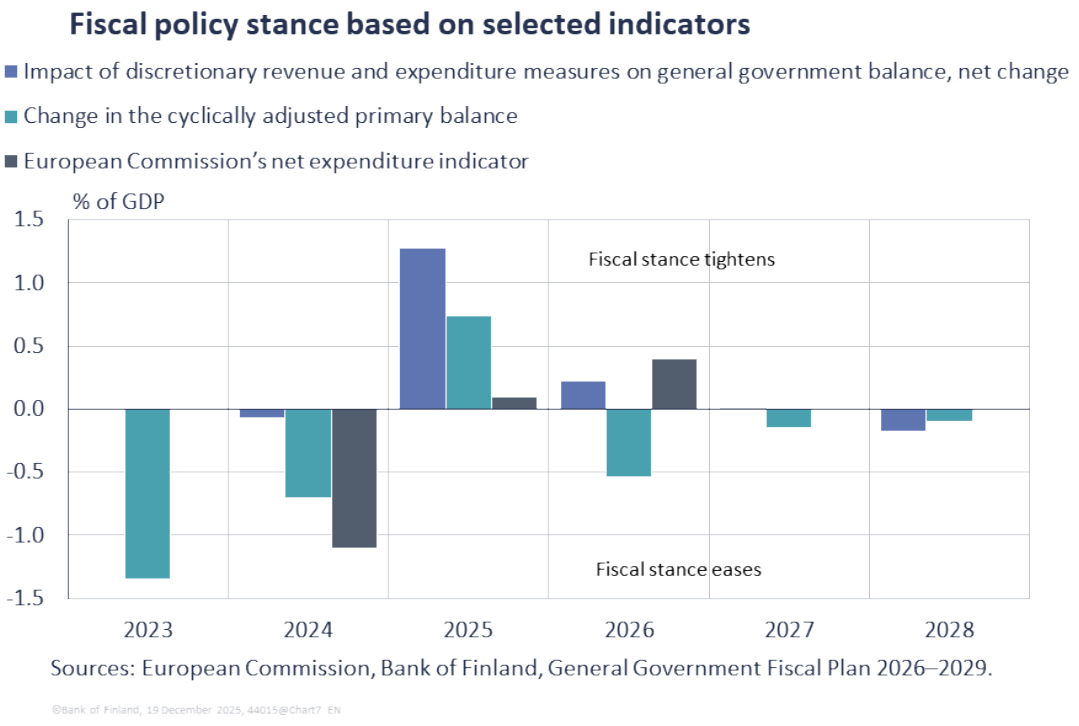
The fiscal consolidation measures implemented by the Government have so far affected 2025 in particular, when the measures strengthened general government finances by an estimated EUR 3.6 billion, or by 1.3% of GDP, compared to the previous year (General Government Fiscal Plan for 2026–2029, pp. 135–136). In the years ahead, the impact of the consolidation measures on the general government balance will be weakened by the tax reduction measures and by the increase in defence spending after the current parliamentary term.

The fiscal stance, i.e. the extent to which fiscal measures impact aggregate demand relative to cyclical conditions, can be assessed in many ways (Chart 8). One way is to assess either the level of or change in the general government cyclically adjusted primary balance. This assessment does not look at changes in debt interest payments, as the focus is on the primary balance because general government interest expenditure does not have a direct impact on domestic demand. A change in the cyclically adjusted primary balance indicates the impulse that general government finances give to the rest of the economy. Another alternative is to examine discretionary measures concerning revenue and expenditure[5] and their impact on the balance. A third alternative is the one outlined by the European Commission, in which the fiscal stance is examined using the net

expenditure indicator[6], where the indicator's growth rate is compared to the medium-term (10-year) average growth rate of potential GDP.

The fiscal stance in 2025 has not been optimal for the cyclical conditions, because economic growth did not pick up as expected but instead halted, although the fiscal consolidation measures were implemented as planned and fiscal policy was tightened. By contrast, in the years ahead, when economic growth is expected to gradually strengthen, it appears that fiscal policy will be fairly neutral or accommodative, measured in terms of changes in the cyclically adjusted primary balance. Interpreting an indicator that is based on fiscal policy measures is generally similar, except that in 2026 the increase in the unemployment insurance contribution will have a slightly tightening impact. On the other hand, the Commission's net expenditure indicator shows the fiscal stance was neutral in 2025 but will tighten in 2026. The difference in the indicators may be due to the assumption concerning the timing of the fighter aircraft procurement. The European Commission's autumn forecast was probably still based on the assumption that the first fighter aircraft to be delivered would be recorded as public investments for 2025.

Chart 8.



Although the cyclically adjusted primary balance has weakened in 11 of the past 16 years, this does not mean that no corrective measures have been taken. An examination of the impact of measures solely affecting taxation and unemployment security shows that they strengthened the general government balance significantly in the period 2011–2016, by a total of some 2.7

percentage points of GDP. At the same time, the economy fell into a downturn. The upward trend in the debt ratio did not come to a halt until 2015–2016, when the public finances were bolstered by fiscal consolidation measures and there was an improvement in economic growth. Subsequently, the debt ratio decreased slightly in the years before the COVID-19 pandemic.

Given the current situation, the fiscal correction would be assisted by a resolute continuation of the consolidation measures as the economy starts to grow. Now, however, the situation is more difficult because the structural deficit is larger than before. In addition, defence spending is now being increased because of the security situation, whereas in the 2010s defence spending decreased relative to GDP.

EU fiscal policy escape clause provides room for an increase in defence spending

Correcting the course of the public finances will be hampered by the expenditure increases planned for strengthening defence. In spring 2025, the ECOFIN Council adopted, on the proposal of the European Commission, a decision on flexibility in the EU fiscal rules, to allow Member States to increase defence spending without violating the EU fiscal rules. A total of 16 EU Member States, including Finland, applied for activation of the national escape clause, which allows an increase in defence expenditure in 2025–2028, provided that debt sustainability is secured. The escape clause would allow extra defence expenditure of up to 1.5% of GDP compared with defence spending in 2021. The European Commission produced for the Member States in question new net expenditure paths, which do not take into account the deficit resilience safeguard and debt sustainability safeguard (COM(2025) 606 final). Assessed in summer 2025, Finland's risk of an excessive deficit could be explained by the increase in defence expenditure. At the time, the Commission anticipated that the deficit in excess of the 3% reference value in 2025 and 2026 would be smaller than the increase in defence expenditure.

The European Commission's autumn 2025 forecast projected Finland's general government deficit to be higher, at 4.5% in 2025 and 4.0% in 2026. Such a large deficit in excess of the reference value could no longer be fully explained by the increase in defence expenditure since 2021, and so the Commission recommended to the Council of the European Union the opening of an excessive deficit procedure for Finland. According to the recommendation (COM(2025) 779 final), Finland would be expected to adjust its structural primary balance by 0.5 percentage points of GDP in both 2026 and 2027. In 2028, the structural balance (including interest expenditure) would need to be adjusted by 0.5 percentage points. This recommendation for adjustments is issued in the context of the expenditure rule (Table 1), from which Finland would nevertheless be allowed to deviate under the flexibility provided by the national escape clause for defence

expenditure.

In the Commission's assessment, the growth rate in net expenditure in Finland has not exceeded the permitted net expenditure growth rate. However, based on the Bank of Finland's forecast, there is a risk that Finland will exceed the maximum growth rates of net expenditure in 2026 and 2027. The maximum permitted deviation from Finland's net expenditure path is 0.3 percentage points yearly or 0.6 percentage points cumulatively, although the assessment of possible deviation would be affected by the activated national escape clause.

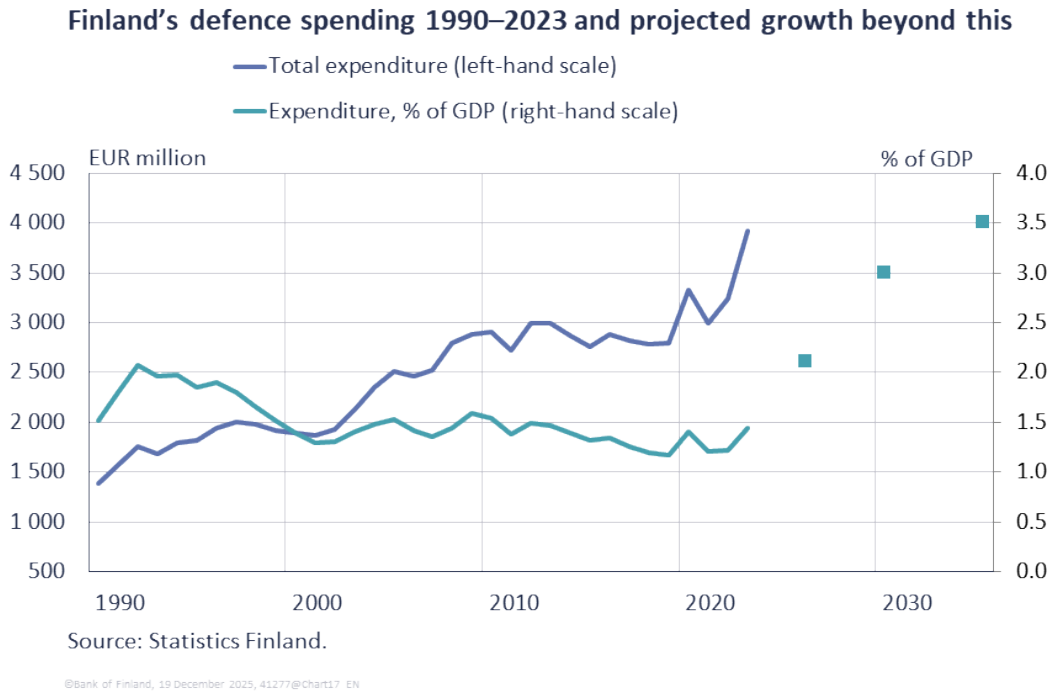
Finland's net expenditure growth in 2024 and forecasts for 2025–2028

Net expenditure, annual change, %	2024	2025	2026	2027	2028
Net expenditure path endorsed by the Council of the EU (21 January 2025)	3.7	1.6	1.9	2.6	2.6
Net expenditure growth permitted by the escape clause (8 July 2025)		2.6	2.7	2.7	2.8
EDP recommendation (12 December 2025			1.3	1.5	1.8
Net expenditure (Ministry of Finance estimate 2 October 2025)	3.5	1.3	1.8		
Net expenditure (European Commission estimate 25 November 2025)	3.25	1.2	1.8		
Net expenditure (based on Bank of Finland forecast)	3.5	−1.1	3.9	3.0	2.7

Finland's defence spending was 1.2% of GDP in 2021. The national escape clause for defence expenditure provides room for increasing defence spending to 2.7% of GDP by 2028. The Ministry of Finance forecast for the level of defence expenditure in 2026 is 2.1% of GDP. In any case, defence spending will continue to grow, and financing this spending will therefore be a major challenge in the years ahead, also beyond the four-year period allowed by the escape clause. Finland has already at an earlier stage committed itself to increasing defence spending to a level of 3% of GDP in 2030 (Chart 9). In addition, the June 2025 NATO summit set a new target for its

member countries, which is to increase defence spending to 5% of GDP by 2035. Of this, 3.5% of GDP would be allocated directly to the armed forces and other military purposes, and 1.5% of GDP would be used for other security-related investments, such as infrastructure and cybersecurity. If Finland is to achieve the 3.5% target, its defence spending as a percentage of GDP should be 2.1 percentage points higher (using NATO's statistical approach) than in 2021.

Chart 9.



Longer term sustainability of public debt

Finland's general government debt ratio is already above the EU average, and for 2025 it is also likely to exceed the average for the euro area countries. The euro area countries' general government debt ratios varied between 23% and 154% in 2024, and Finland's debt ratio is currently the seventh highest in the EU and the euro area. Medium and long-term debt sustainability analyses show that altering the trend in Finland's public debt requires significant fiscal consolidation, given the current growth forecasts.

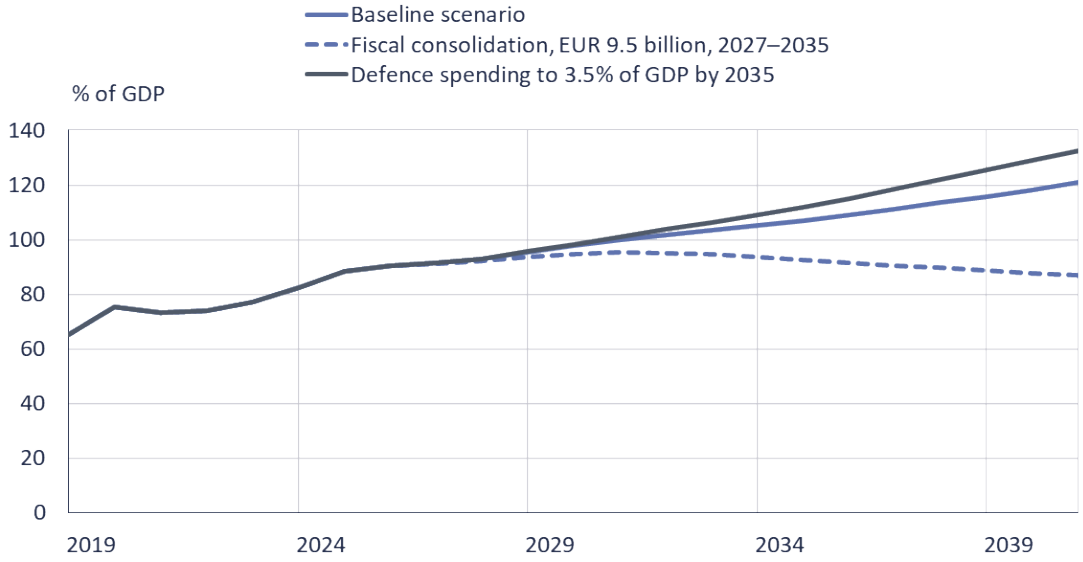
The increases in defence spending, including the fighter aircraft procurement, are currently financed by debt. In the longer term, however, the spending increases must be financed by reducing public expenditure elsewhere or by increasing tax revenues. Finland's general government debt ratio will rise to 118% by 2040 if no changes affecting revenue or expenditure are made after 2028, the final year of the forecast, and if, at the same time, the growth in age-

related expenditure is assumed to continue (Chart 10, baseline scenario). If, in addition, defence spending is steadily increased to 3.5% of GDP by 2035 and other expenditure is not reduced correspondingly, the debt ratio would rise to almost 130%. The debt ratio in 2040 would then be more than 10 percentage points higher than under the baseline scenario.

Turning the debt trajectory around will require significant fiscal consolidation in the coming years. Technical quantifications of the pressures on the public finances suggest that a fiscal consolidation of approximately EUR 10 billion, distributed evenly from 2027 up to 2035, would be sufficient to turn the debt ratio onto a slow downward trajectory. If defence spending is increased without reducing other expenditure, the required fiscal adjustment would be greater. However, it should be noted that for the period beyond 2030 these calculations do not take into account the requirements of the EU fiscal rules regarding the pace of fiscal adjustment or the requirements of national legislation.

Chart 10.

Public debt ratio under different scenarios



Sources: Statistics Finland and Bank of Finland.

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The long-term debt trajectory up to 2070 can be assessed by means of technical quantifications of fiscal pressures, which assume that the service needs arising from demographic changes will be met, but otherwise public revenues and expenditure (excl. debt interest payments) will remain unchanged. In these calculations, debt sustainability has traditionally been measured using the S2 sustainability gap indicator, which indicates the extent of a one-off fiscal adjustment needed for stabilising the debt ratio immediately. According to the Bank of Finland's current estimate, the

sustainability gap in Finland's public finances after the end of the forecast period, as from a 2029 base year, will be about 3% of GDP. The estimate has increased from the estimation made at the end of 2024, due to the current higher estimate for structural deficit in the base year of the calculation and higher market expectations for the interest rate on public debt in 10 years' time. If the one-off fiscal adjustment determined by the S2 indicator were to be made, the debt ratio would stabilise at approximately 98% according to the calculation.

How can the trend in Finland's public debt ratio be reversed? National fiscal rules legislation and parliamentary practices

The EU Budgetary Frameworks Directive requires the establishment of fiscal rules in national law. Act 869/2012, known as Finland's Fiscal Policy Act, no longer conforms with the requirements of the revised EU regulatory framework. Therefore, in July 2025, the Ministry of Finance issued a draft act on the management of Finland's public finances, which was discussed by a cross-party parliamentary working group following comments received in a consultation round. The aim was to secure broad parliamentary support for a government bill. The working group revised the draft act so as to secure a sufficiently broad consensus among the parliamentary parties.

According to the government bill submitted in the Government's proposal on the act (HE 167/2025 vp), a numerical target of 60% of GDP, and in the long term 40% of GDP, would be set for the general government debt ratio. For a small open economy in a monetary union, such as Finland, a debt ratio target that is significantly lower than the current one is justified in view of the economy's sensitivity to cyclical fluctuations and the need to ensure adequate fiscal space. However, it should be noted that achieving the target may take decades, as Finland's debt ratio is already approaching 90%. It is therefore reasonable to set interim targets for 1–2 parliamentary terms.

According to the government bill, the fiscal rule would be based on targets set by the Government for the fiscal balance of central and local government. The targets would be set in such a way that 1) they would promote compliance with the EU reference values for deficit and debt; 2) they would meet the commitments of the national medium-term fiscal-structural plan under the preventive arm of the Stability and Growth Pact; 3) the target set for a parliamentary term would facilitate achievement of the fiscal balance target for the inter-parliamentary period extending across parliamentary terms and 4) the target for the inter-parliamentary period would ensure that the debt ratio decreases towards its long-term target by an average of 0.75 percentage points each year over the next 8 years.

The parliamentary working group will, in the midpoint of the Government's term, prepare a target

for the inter-parliamentary period. In the year preceding elections it will also draw up a target for the subsequent parliamentary term. The government bill allows a temporary deviation – during exceptional crisis conditions – from items 3 and 4 specified above, which are based on additional national requirements. In this case, the national independent fiscal institution will assess the grounds, duration and size of the deviation and its impact on fiscal sustainability. It will be reasonable to deviate from the rules if, when setting the fiscal balance target, it is already known that the situation is exceptional.

Hence, based on the government bill, the national target could be stricter than required by the EU rules when the debt ratio is below 90%. In the years 1995–2008, the debt ratio decreased at an average rate of 1.5 percentage points per year. It is therefore possible that the 0.75 percentage point target is too lenient during economic upturns and too strict during downturns. In principle, this would not be a problem because the target pertains to the debt ratio's average rate of decline. On the other hand, especially during economic upturns, it may be possible to increase permanent spending and still achieve the fiscal balance target, although this could backfire in times of weaker cyclical conditions. When the economy is doing better than expected, fiscal buffers should be strengthened for times that are less favourable.

The debt sustainability requirement is operationalized in the EU fiscal rules by adjusting and monitoring the growth rate of general government net expenditure. The government bill makes no mention of an expenditure rule even though the expenditure reference trajectory provided by the European Commission is one of the factors in setting the fiscal balance target. The advantage of an expenditure rule would be that expenditure growth (and the impact of discretionary revenue measures) would be easier to control than net lending, which is also affected by the more cyclically sensitive revenue side.

Achievement of the national fiscal balance target does not necessarily mean that the net expenditure path under the EU fiscal rules can be adhered to, if both revenue and expenditure grow faster than expected. It is therefore important that the EU fiscal framework expenditure rule is monitored, and it could also be useful to incorporate an expenditure rule in the national fiscal framework.

The government bill includes provisions on the annual General Government Fiscal Plan. The target for the inter-parliamentary period will be set in the General Government Fiscal Plan drawn up in the midpoint of the parliamentary term. The General Government Fiscal Plan and the central government spending limits set within it are a key part of Finland's fiscal governance framework. It is therefore welcome that the spending limits procedure will now be laid down in law. However, the Government will still have plenty of room for manoeuvre when setting spending limits. When updating the national fiscal framework, it would be useful to further formalise the central

government spending limits procedure. In the government bill, it would be possible to link the net expenditure rule as a precondition for setting the central government spending limits. This way the setting of spending limits would be more directly connected to a net expenditure rule, and the national fiscal framework would thus act in support of the EU fiscal rules. As the tasks given to the parliamentary working group include determining the acceptable room for manoeuvre in utilising revenue from the sale of assets, it might be useful to also consider giving the working group a role in setting the central government spending limits.

The Government will assess the achievement of the fiscal balance target for the parliamentary term on an annual basis in the General Government Fiscal Plan and also when preparing the budget proposal. The government bill states that the Government will take corrective measures if, in its own assessment, there would be a breach of the fiscal balance target for the parliamentary term or if general government net lending for the prevailing or subsequent year would be weaker than -2.5% of GDP. Corrective measures would also be required if the European Commission or the Council of the EU were to assess that Finland is at risk of deviating from the net expenditure path. It is good that corrective measures would also be required on the basis of deficits projected for the prevailing and subsequent year, as measures could be taken in sufficient time in view of the parliamentary-term target.

The proposed fiscal framework would include a three-stage correction mechanism. The first stage would be based on the national independent fiscal institution's annual or more frequent assessment of the achievement of the fiscal balance target for the parliamentary term, the measures taken by the Government and the general government net lending for the current and following year. This stage would concern the national fiscal balance target defined in the General Government Fiscal Plan. If the independent fiscal institution considers that there is no acceptable justification for a deviation that may have been made from the fiscal balance target, it will present its assessment of the extent and timing of the necessary corrective measures.

Under the proposed framework, this stage would not actually require corrective measures if the Government publicly justifies its decision not to take further action. The first stage of the mechanism may therefore turn out to be rather weak. The second and third stages of the correction mechanism relate to the EU's excessive deficit procedure, and they require the Government to either submit a report or a statement to Parliament on the additional measures to be taken. The proposal does not indicate whether the achievement of the targets will be assessed in some way afterwards or how the process will correct itself if the outcomes deviate from those planned, especially at the start of a parliamentary term. It is possible that, for example, the debt ratio reduction target is met, but the fiscal balance target is not, or vice versa.

Nevertheless, the national correction mechanism would be supported by the fact that the

independent fiscal institution's report would be submitted annually to Parliament by the end of February. The parliamentary oversight of fiscal surveillance would be an important part of the national assessment of fiscal policy. In addition, the proposed timeframe would allow the Government to react and announce possible measures as part of the government report on the General Government Fiscal Plan, for example.

The Budgetary Frameworks Directive requires national legislation from 1 January 2026, but for the more demanding elements of national regulation, the provisions would not enter into force until 2031. During the transition period 2026–2030, the Government would be required to set a fiscal balance target that would ensure the commitments of the EU legislation and Finland's medium-term fiscal-structural plan are followed. The transition period is necessary because of the increase in defence spending and the related validity period of the EU's national escape clause. After the transition period, curbing debt growth in the early 2030s is likely to be just as difficult as in the late 2020s. At the same time, fiscal consolidation will be hampered by the fact that the structure of public expenditure will have to be altered due to the increase in defence spending.

On the basis of a government bill, the fiscal surveillance tasks would be assigned to the Finnish Economic Policy Council. At the same time, the role of the National Audit Office of Finland in fiscal surveillance would be reduced to the ex-post evaluation of the Ministry of Finance's economic forecasts. The government proposal for the bill justifies assigning the fiscal surveillance tasks to the Finnish Economic Policy Council on the grounds that in most Member States these tasks have been assigned to an expert body composed of people with an academic economics background. Bringing together all fiscal surveillance resources is justified in itself, but the Finnish Economic Policy Council must have sufficient resources to perform its tasks, and its independence is an absolute requirement.

From targets to action, from action to results

Turning Finland's debt ratio onto a declining path more permanently requires time and the entire fiscal policy toolkit. Expenditure must be cut and reallocations made, but also revenues must be maintained, and structural reforms must continue. Finland has, in principle, a good chance of succeeding in its fiscal consolidation, because we have strong institutions and a reputation for reliability in repaying public debt.

Analysis by the IMF (Balasundharam et al., 2023[7]), based on research literature, shows that successful fiscal consolidation in advanced economies generally requires strong institutions, a sound history of fiscal management, broad political support and favourable economic conditions. The short-term effects of fiscal consolidation depend on the structure of the economy and cyclical

conditions: consolidations based on expenditure cuts increase income inequality more often than tax-based ones, and rapid consolidation often widens income inequality as well, but labour market reforms and targeted social benefits can mitigate the negative effects. A credible and well-communicated plan facilitates access to finance and increases room for manoeuvre. A typical adjustment is 1%–2% of GDP annually over a period of 3–4 years. Major fiscal consolidations require both revenue and expenditure measures, but cuts in investment, education and healthcare should be avoided. A credible medium-term fiscal framework and strong institutions are necessary for supporting the consolidation measures.

A study by the European Commission (European Commission, 2025, Part III[8]) supports the conclusions of the IMF's analysis. Firstly, it notes, timing is key: measures should be taken during an economic upswing, when their adverse impact on growth would be less and credibility higher. Secondly, the content of the fiscal consolidation is important: packages based on expenditure cuts are generally more durable than those based on tax increases, and public investment should be protected. Thirdly, strong institutions and clear fiscal rules increase market confidence and reduce financing costs. Furthermore, the consolidation must be consistent and must take a long-term view, and not be solely based on one-off measures. Political commitment and open communication are also key, if the measures are to be accepted and their effects to last.

Considerable care must be taken with fiscal consolidation to avoid weakening the conditions for economic growth while also ensuring social cohesion. Therefore, a steady, gradual and determined approach will produce better results than a sudden, major consolidation implemented under great pressure. The IMF's recommendation for Finland in October 2025 was to further consolidate the public finances by 0.5% of GDP annually, until the fiscal balance is closed and debt begins to decline.[9] In general, an expenditure-focused consolidation is recommended for advanced economies, but, especially when the adjustment need is high, tax measures are also necessary.

Both the parliamentary commitment made to increasing public R&D funding and keeping other public investments at a sufficient level, albeit currently in the form of a fixed-term investment programme, are important elements for ensuring the quality of public expenditure. It is also important to ensure that sufficient resources are allocated to education if the goal of raising the level of educational attainment in Finland is to be met. The Ministry of Finance has announced that it will carry out both annual thematic spending reviews and, prior to elections, more extensive spending reviews. Based on better information, better decisions can be made, making it easier to anticipate their consequences.

Measures to increase taxes should not be excluded altogether, even if the main focus of consolidation is on the expenditure side. Higher taxation should generally focus on areas that have

less of a distorting effect on economic activity, such as property and environmental taxes. Taxation can be used to guide the behaviour of economic agents for the purpose of, for example, achieving climate goals and at the same time supporting the public finances. Changes to the tax structure should be financed as much as possible using measures that have an immediate effect, so that the revenue shortfall from tax cuts is not offset by mere expectations of dynamic effects. In connection with the 2026 cuts in personal taxation, some tax deductions will be discontinued, but the measures to reduce taxation will still exceed the taxation raising measures by more than EUR 750 million. In 2027, the immediate balance of tax measures will also be negative and just as large, which is why reducing corporate income tax should be counterbalanced by cutting direct business subsidies and tax expenditures aimed at businesses. It is important that changes in taxation are based on the latest information available on the tax structure and on the effects of taxation.

The major increase in defence spending will make fiscal correction more difficult in the coming years, especially as the dependency ratio continues to weaken and age-related expenditure continues to increase. There is a risk that necessary measures will not be taken, despite the awareness of future pressures on expenditure – in the same way that it was previously possible to predict the impact of an ageing population. The parliamentary consensus reached on fiscal policy targets highlights the need for resolute steps in fiscal consolidation and a longer term perspective across parliamentary terms, and increases Finland's credibility in the eyes of lenders. There has been no shortage of ambitious targets in the past either, but now it is time to take action and get results.

Notes

1. The primary balance is general government net lending excluding interest payments. ↑
2. Excessive deficit procedure (EDP) debt differs conceptually in respect of its central government debt component from the central government debt figure published by the State Treasury. The former also includes loans granted to beneficiary countries by the European Financial Stability Facility (EFSF), received cash collateral related to derivative contracts, the capital of the Nuclear Waste Management Fund, debt generated from investments in central government's public-private partnership projects, coins in circulation, and deposits of the European Commission. Nowadays, ARA interest subsidy housing loans are also included in central and local government EDP debt. (Source: Statistics Finland.) ↑
3. The mathematical formulae describing changes in the general government debt ratio can be found in e.g. Escolano (2010): A Practical Guide to Public Debt Dynamics, Fiscal Sustainability, and Cyclical Adjustment of Budgetary Aggregates, IMF Technical Notes and Manuals 10/02. (https://www.imf.org/en/publications/tnm/issues/2016/ 12/31/a-practical-guide-to-public-debt-dynamics-fiscal-sustainability-and-cyclical-adjustment-of-23498). ↑

4. Output for own final use refers to production used by public sector entities themselves, for example the construction of their own buildings or the development of information systems. ↑
5. In this approach, index adjustments to income tax scales are not considered to be discretionary measures, as their purpose is to prevent taxation from rising automatically as a result of a general increase in prices and wages. A decision not to make index adjustments would be considered a fiscal measure. This principle is also applied in the calculation of the EU's net expenditure indicator. ↑
6. The net expenditure indicator refers to the annual change in public expenditure after excluding debt interest payments, cyclical unemployment expenditure, programmes funded by the EU, and the national share of expenditure that is co-financed with the EU. The expenditure aggregate arrived at is then reduced by an amount equivalent to the discretionary revenue measures. ↑
7. Balasundharam, V., Basdevant, O., Benicio, D., Ceber, A., Kim, Y., Mazzone, L., Selim, H. and Yang, Y. (2023), Fiscal consolidation: Taking stock of success factors, impact, and design, Working Paper No. 2023/063, International Monetary Fund, https://www.imf.org/-/media/files/publications/wp/2023/english/wpiea2023063-print-pdf.pdf. ↑
8. European Commission, Directorate-General for Economic and Financial Affairs (2025), Report on Public Finances in EMU 2024, European Economy Institutional Paper No. 325, Publications Office of the European Union, https://doi.org/10.2765/3883793. ↑
9. The IMF's concluding statement on the Finnish economy 10 November 2025. ↑

Keywords

debt, deficit, fiscal policy, public finances, sustainability gap