New Centre-Right government in Finland: economic and European challenges and perspectives

Etzold, Tobias; Tokarski, Pawel

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Economic and European Challenges and Perspectives

Tobias Etzold and Paweł Tokarski

Finland is directly affected by two of the biggest crises in the history of European integration: the troubles of the euro and the Russia-Ukraine conflict. The new Finnish government, formed by the liberal Centre Party, the populist Finns Party and the conservative National Coalition Party, faces major economic, foreign policy and security challenges, but fundamental change in its policy towards the EU and the eurozone is not to be expected. The coalition's stability will depend not least on whether it embarks upon urgent structural reforms, and whether or not they are successful. The outcome of the reform process will also affect Finland's political influence within the European Union and the situation of the German-led coalition of the most competitive eurozone members.

Juha Sipilä's liberal Centre Party emerged the winner of the Finnish parliamentary elections held on 19 April 2015, with the conservative National Coalition Party of outgoing Prime Minister Alexander Stubb and Timo Soini's populist Finns Party close behind. It is these three parties that have formed the new centre-right coalition. The main issue in the election campaign was the precarious state of the Finnish economy, which finds itself in its weakest phase since the severe structural crisis of the early 1990s.

Thanks to its model economy, Finland was long regarded as a poster child of the Union and became one of Germany's closest partners in the euro crisis. But massive economic problems now threaten the country's influence and standing, especially after it lost its AAA credit rating in October 2014 – which had put Finland in the elite circle of financially strong EU states.

Finland's EU Policy: Pragmatically Firm and Constructive

Since joining the European Union in 1995, Finland has been regarded as the most pro-EU and integration-friendly of the Nordic states. Helsinki has never demanded opt-outs, and participates fully in all EU policies. It introduced the euro in 2002, as the only Nordic country yet to do so. Overall, Finland's EU policy can be characterised as flexible, pragmatic and constructive. Despite its peripheral situation in north-eastern Europe, the country has worked to gain acceptance in the inner circle of the European Union. In particular, its accession to

Dr. Tobias Etzold and Dr. Paweł Tokarski are Associates in SWP's EU / Europe Division. This paper is published
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the third stage of Economic and Monetary Union in 2002 was driven by that wish, alongside economic rationale. Finland's political elite believed that the best channel through which to pursue national interests was active and constructive participation in EU decision-making processes. EU membership also contributed to economic recovery after the recession of the early 1990s.

Finland was quick to introduce its own initiatives in the EU framework. Through the policy of the Northern Dimension, Helsinki sought to build bridges between the EU member states, the then accession candidates (the Baltic states and Poland), and Russia, and to embed its interest in good neighbourly relations with Russia in a European context. Its pragmatic bilateral relationship with Moscow makes Helsinki a central actor in matters concerning Russia. But Finland's relations with Russia have also darkened in the course of the Ukraine crisis. Although the Finnish economy is directly affected by the EU sanctions imposed on Russia and Russia's counter-sanctions, Helsinki backed the EU sanctions after initial doubts. The latest developments concerning Ukraine have set new accents in the debate over Finland's national security and defence capability. In its defence policy Finland is seeking to close ranks with its Nordic neighbours, the European Union and NATO, and is openly discussing the option of joining NATO (see SWP Comment 25/2015).

Since 2011, the European economic and financial crisis and the influence of the populist Finns Party have injected a more EU-sceptical tone into the debate on Europe – even in Finland. This growing scepticism has had immediate effects on Finnish Europe policy and Helsinki's stance in EU negotiations.

During the euro crisis, Finland often adopted more radical positions than Germany, and pressed hard for action on reform and budget consolidation. Helsinki's image as a "Euro-hawk" was underlined in 2011 and 2012, when it made participation in bailout packages conditional on collateral. Helsinki also vehemently rejected any moves towards communitisation of eurozone debt, fearing that this would blunt the will to carry through reforms in the crisis countries.

As well as observing that Finland is "more German than the Germans" on fiscal consolidation and reforms, another aspect of particular interest to Berlin should not be underestimated. The Finns have successively earned a reputation as credible and stable partners who clearly articulate their political preferences in talks and adroitly place their own candidates behind the levers of economic power in Brussels. For example, Olli Rehn became one of the key figures in the euro crisis as Commissioner for Economic and Monetary Affairs between 2010 and 2014.

Fraught Economic Situation

But now Finland requires crisis therapy of its own. The decline of traditional motors of growth – Nokia and the timber and paper sectors – has hit the Finnish economy hard, with the sanctions imposed on Russia by the European Union and Russia's counter-sanctions exacerbating economic woes. Germany is now the largest market for Finnish exports, with Russia dropping from first to third place after the volume of imports from Finland fell by 14 percent in 2014. The severe structural problems of the Finnish economy demand deep reforms; tinkering will not suffice. But to date none of the parties has presented a convincing concept. A package of social and healthcare reforms introduced by the old government was defeated in parliament in March 2015. In May 2015 the European Commission ruled that Finland had exceeded the deficit and debt criteria of the EU Treaty. The Commission sees Finland's public finances endangered by a "high sustainability risk in the medium term" due to the "budgetary impact of the cost of ageing". Price competitiveness has also been weakened by unit labour costs rising more quickly than in many other European countries since 1999.

The new Finnish government thus faces numerous difficult decisions. It must reduce public spending, which as a proportion of GDP is among the highest in the OECD. But this may be difficult to accomplish, because the governing parties hold different positions. There is also a danger of budget consolidation having a negative effect on growth. On the other hand, the Finnish economy possesses a string of locational advantages in comparison to other members of the currency union. In international rankings of the innovativeness and quality of tertiary education and vocational training Finland occupies top places. In 2013 Finland's level of investment in research and development was the highest of any EU member state (3.3 percent of GDP).

These economic difficulties, and comparisons with the flourishing economy in neighbouring Sweden, regularly stoke public discussion about whether to remain in the eurozone. But the risk of Finland leaving is presently small. On the other hand, a Greek exit or default would burden all the members of the eurozone with additional costs. Opposition to the euro in Finland could grow, as could scepticism towards future rescue packages or deeper economic integration.

Instead of Timo Soini, who questions current EU bailout policies and had been tipped for the post, Alexander Stubb was appointed finance minister. He is an experienced pro-European, but his latitude is constrained by the new government's announcement of cuts in state spending of €4 billion by 2019, which will hit social programmes especially hard. Given that Sipilä may have to agree compromises that are unpopular at home, the new government is likely to take a harder line in new negotiations with Greece. The opposition of both the Centre Party and the Finns Party to negotiations over a new rescue package increases the complexity of the ongoing talks with Athens. Altogether, conflicts between the three governing parties can be expected over Finland's future economic, EU and eurozone policies. Some of the positions of the Euro-sceptic Finns Party are miles apart from those of their considerably more EU- and euro-friendly coalition partners, the Centre Party and the National Coalition Party.

Finnish-German Cooperation

To date Berlin and Helsinki have shared similar ideas about the reforms that need to be made in the Economic and Monetary Union. And as far as national responsibility for domestic economic policy is concerned, the Finnish position is very similar to the German. Both countries also share the same scepticism towards a mutualisation of national debt.

But there are also differences. Helsinki would like to simplify EU fiscal rules and narrow the latitude enjoyed by the European Commission. After France and Italy received mild treatment from the European Commission with Berlin's tacit approval, Helsinki fears unequal treatment of smaller eurozone members. The new Finnish government stresses national accountability for economic and budget policy and favours reinstating a strict "no-bailouts" principle. Helsinki also rejects treaty reforms, which it regards as unnecessary and politically risky, more clearly than does Germany. Finland's line is that a new legal and institutional framework is not needed; the existing rules suffice, and merely need to be observed properly.

But on other economic matters within the EU, Germany can count on Helsinki, especially when it comes to preserving the "four freedoms" and deepening the internal market. This will be important in the foreseeably tough talks with the British. Finland explicitly supports the new free trade agreement with the United States (TTIP). Germany in turn hopes for support from Finland, as a fellow net payer, in the upcoming negotiations over a new EU multiannual financial framework (2021–2027).

Union Needs Finnish Influence

The new Finnish government will have to make difficult political decisions, and faces a litmus test that will determine its credibility within the eurozone. Finland has always demanded its partners make deep structural adjustments when they have needed financial support. Should Helsinki prove incapable of carrying through similar reforms of its own, this would not only harm its reputation in the eurozone but also weaken the German-led coalition pressing for structural reforms. The other EU member states should observe closely what economic reforms Finland pursues and whether they turn out to be successful. Many of the challenges facing the Finnish economy are also replicated elsewhere: declining competitiveness, lack of growth impulses, an overdimensioned public sector, comparatively high labour costs, and population ageing.

Consequently, Finland's reform process can supply useful insights for reforms in other eurozone countries. If Finland's economic reforms turn out to be successful, that will strengthen its position and influence in the European Union. Its influence would increase still further if the new government upheld the country's constructive approach in EU and eurozone negotiations. With respect to pragmatic dealings with Russia, the Union can also continue to profit from Finland's experience. The new government, for its part, has stated that it will abide by the Union's policy towards Russia, but will also seek to maintain diverse bilateral relations with its eastern neighbour.

It remains to be seen what role the new foreign minister and avowed eurosceptic Timo Soini will play in future Finnish policy. After his nomination, Soini said that Finland was committed to membership, but the Union must reform. He will, he said, remain a critical friend of the European Union.

While there may be uncertainties about the new government in Helsinki, a strong supporting voice from Finland is of great importance in a phase of European integration that will be decisive for the future of the eurozone and EU-Russia relations.

SWP
Stiftung Wissenschaft und Politik
German Institute for International and Security Affairs

Ludwigkirchplatz 3–4
10719 Berlin
Telephone +49 30 880 07-0
Fax +49 30 880 07-100
www.swp-berlin.org
swp@swp-berlin.org

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