EDITORIAL

Determined action needed to strengthen the economy

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Resolving the protracted problems in the Finnish economy requires action in three areas. It is necessary to improve cost-competitiveness, continue structural reforms and end growth in the public debt.

The outlook for the Finnish economy remains subdued. According to the Bank of Finland forecast, economic growth will gradually gain momentum, albeit still remaining slower than the euro area average. The problems in the economy have turned out to be of a long-term nature. Since 2008, there have been particularly strong reductions in exports and corporate investment in export sectors.

General government finances are weak. Relative to GDP, the general government deficit has grown above 3%, and general government debt above 60%. In the absence of new decisions, the debt will continue to grow at a rapid pace.

Finland has witnessed the arrival of a large number of asylum seekers in 2015. The impact of increased immigration on the long-term trend of the public finances will largely depend on how well the persons settling in Finland and their eventual descendants can find employment. Their employment rate immediately following immigration will be lower than the average for the population as a whole, but over time more and more immigrants can be expected to find jobs as their language skills and other capabilities improve. Research data suggests that official integration measures can have a considerable impact on immigrant employment.

Resolving the protracted problems in the economy requires action in three areas. The first of these is to improve cost-competitiveness. The second involves structural reforms to enhance the preconditions for economic growth and the long-term sustainability of the public finances. Finally, consolidation measures are needed to halt the growth in the public debt.

Cost-competitiveness in Finland has declined significantly since 2007, in particular. Compared with the average in the country's trading partners, the price of labour has risen faster and firms' capacity to pay wages has been weaker in Finland. The profitability of output generated in Finland has worsened notably in the export sectors. The pay settlement agreed in autumn 2013 ended the weakening trend in cost-competitiveness but did not yet lead to essential improvements, as the rate of increase in the price of labour has, on average, also remained slower than usual in the trading partners.

Solutions are now required that will lead to sufficiently large and rapid improvements in cost-competitiveness. Such solutions would boost the outlook for exports and export sector employment. Simultaneously, they would make a sustainable contribution to favourable employment developments in home market sectors.

In the area of structural reforms, the pension reform passed by Parliament this year is very important. However, it will not be sufficient on its own. It is crucial for the social and health care reform to be completed in a manner that will ensure productivity improvements in the public services. The Bank of Finland has also highlighted other areas of structural reform in which the implementation of measures would have significant implications. Regulation restricting competition can be reduced in certain sectors, conditions for growth in the supply of housing can be improved and working careers can be lengthened not only from the end but also from the beginning and in the middle.

As the problems of the Finnish economy apply, in particular, to exports and investment by exporters, a fiscal stimulus will offer no solutions. Export output cannot be supported by stimulus measures maintaining domestic demand and increasing debt.

Since 2008, Finland has pursued one of the most relaxed fiscal policies in the EU. In 2009 and 2010, the policy was eased, and the tightening of recent years has been considerably more moderate. The most common, internationally comparable measure of fiscal expansion is a change in the general government cyclically-adjusted budget balance. According to this measure, no other EU country's fiscal policy has supported economic growth as much as Finland's, when the current situation is compared with that of 2008.

Growth in public debt would be less of a problem if a prolonged period of strong economic growth were to be expected. In Finland, on the contrary, the additional debt now being taken on will need to be serviced in the future in an environment where a smaller proportion of the population is of working age and a greater proportion is in retirement, and where more people than at present are in need of health and care services.

It is therefore vital to reduce the general government deficit. In order to reverse the trend in the growth of public debt, spending cuts will need to be made on a broad front. If consolidation measures are not taken, those who are now young will need not only pay the bulk of the baby-boomers' pensions and health and care services but also service the previous generations' debts. In addition, they will need to find employment in an economic situation where the problems may still be unresolved.

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Tags

cost competitiveness, structural reforms, public debt