

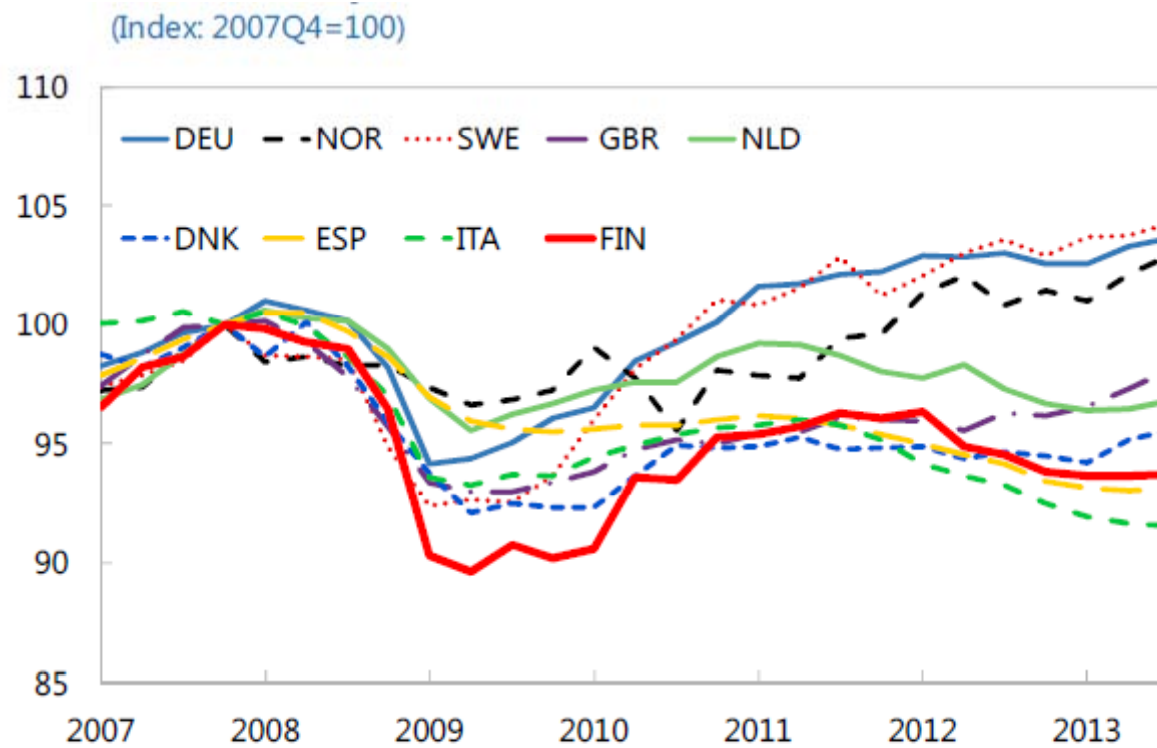
THE ECONOMIC CRISIS IN FINLAND

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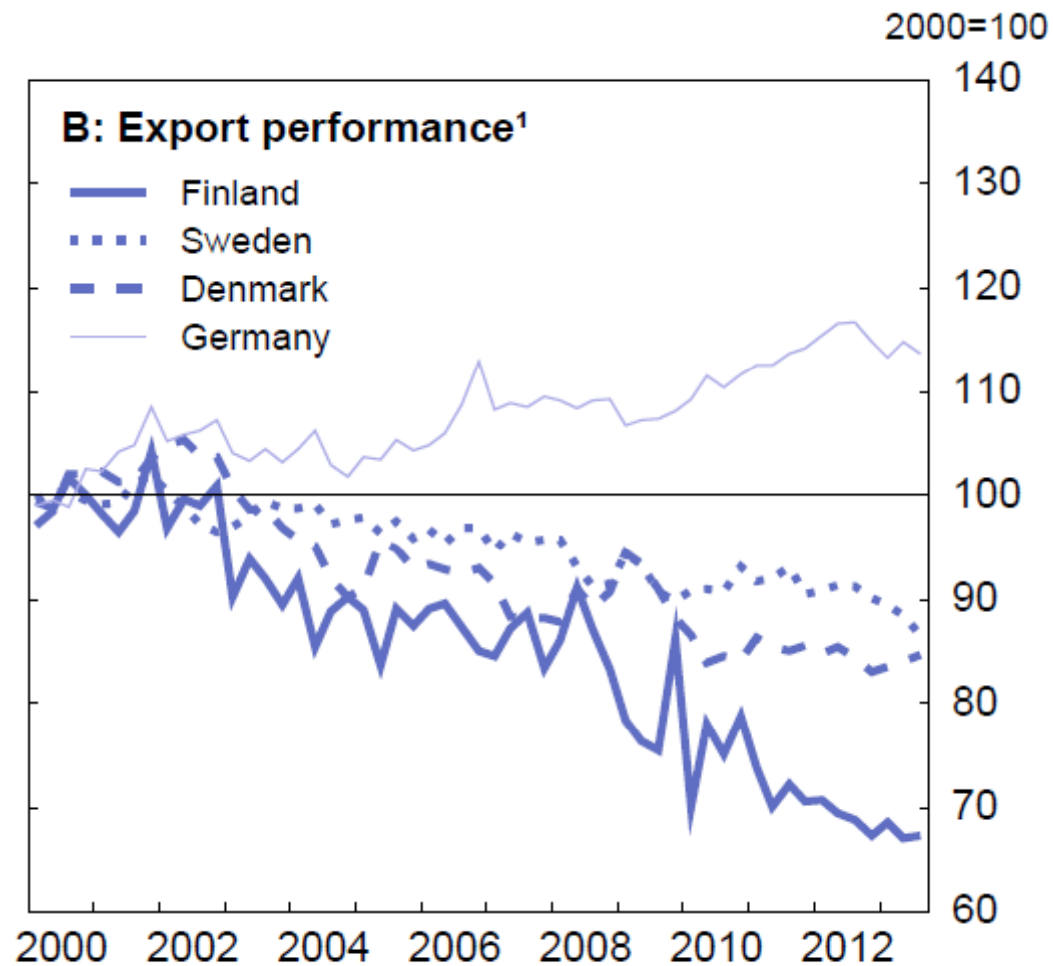
Finland has been hit harder than most

GDP Developments

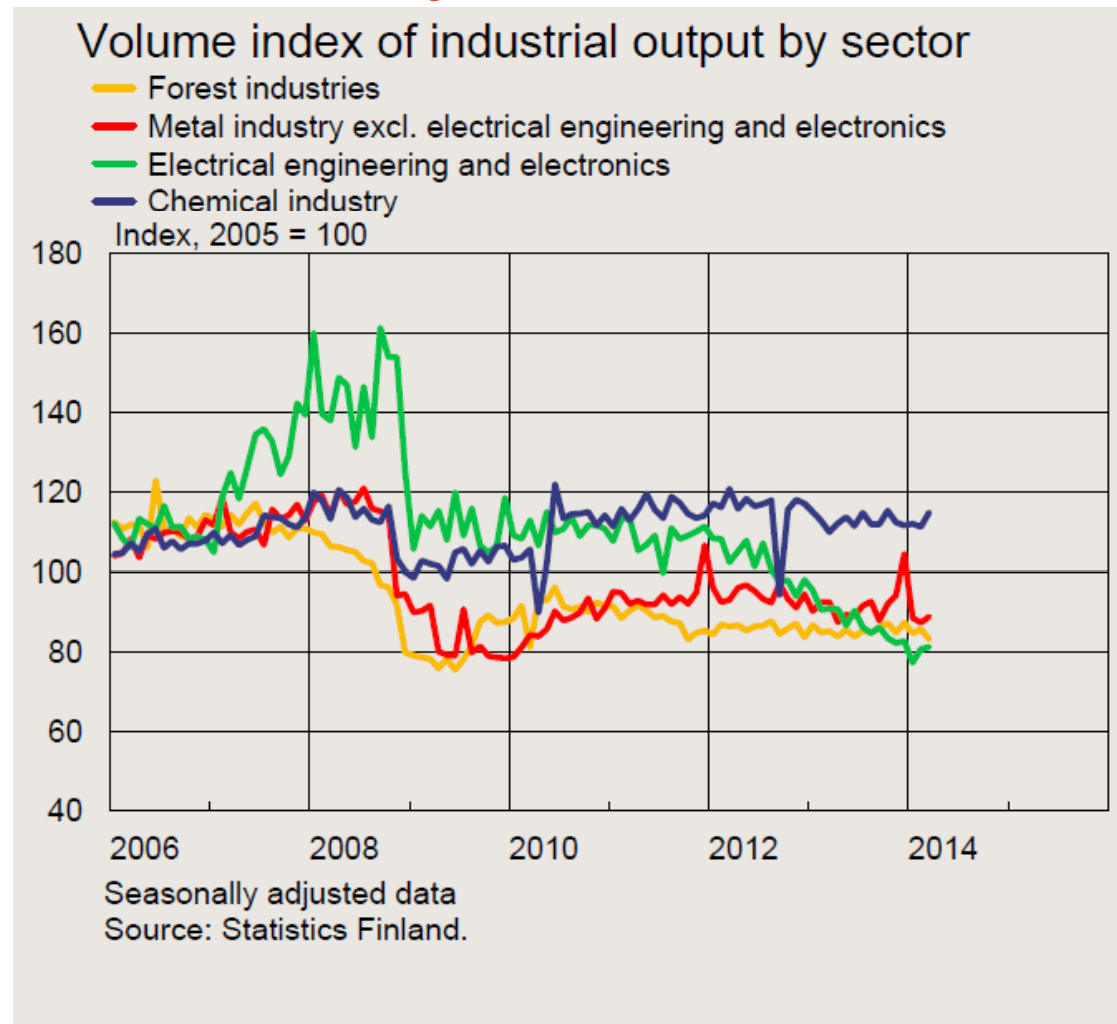


Source: Fund staff calculations.

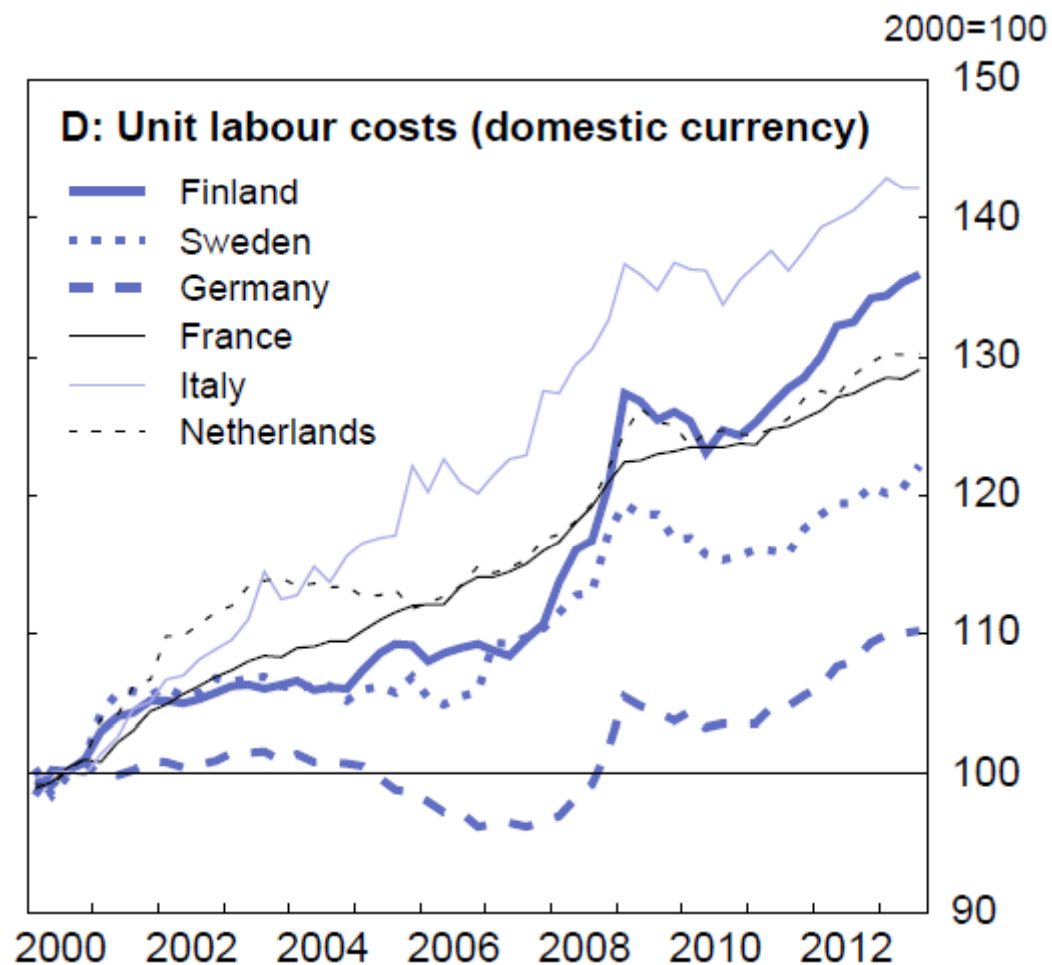
The export sector has been particularly weak



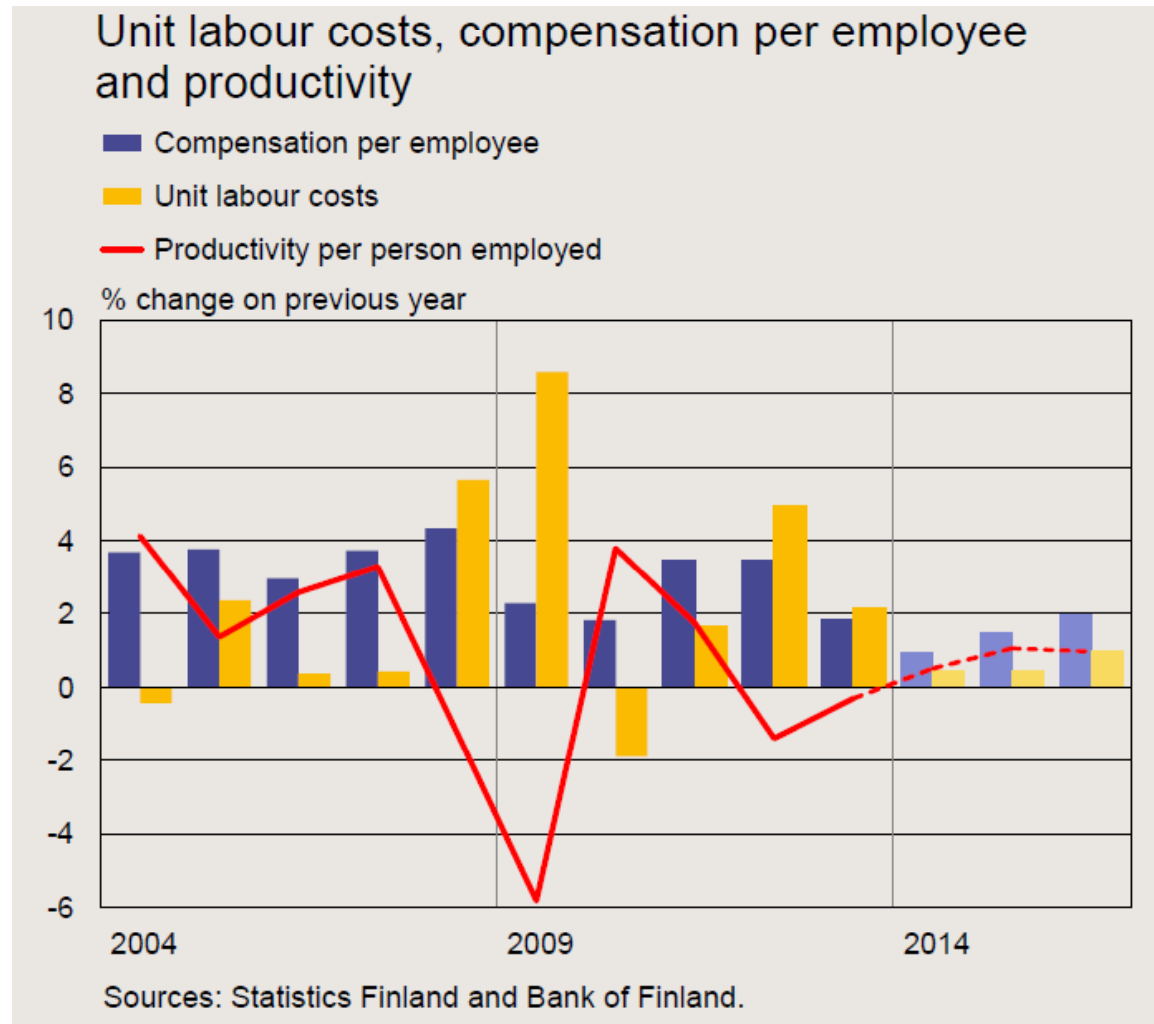
Structural problems in telecommunication and forest industry



The competitiveness has deteriorated significantly



A large reduction in productivity and slow wage adjustment



Wage adjustments have been slow

- Wage increases have been slow to adjust
- Initially it was difficult to assess whether the low productivity was temporary or permanent
- The deterioration of central co-ordination worsened the problem
- But the current pact for employment and growth has not improved competitiveness so far

Productivity can not be the only solution

- Finland has been well position for strong productivity growth
 - Well educated work force and well functioning education system
 - High rates of R&D investments
 - Low costs of doing business
 - Open economy
 - Labour market relatively flexible
- But some things have changed
 - Important sectors with high technological level has decreased
 - The capital investments have been low
 - Tax burden are higher than in most other countries
 - The productivity in important parts of the economy seems to be low
- There are few low hanging fruits for Finland

To regain competitiveness is challenging

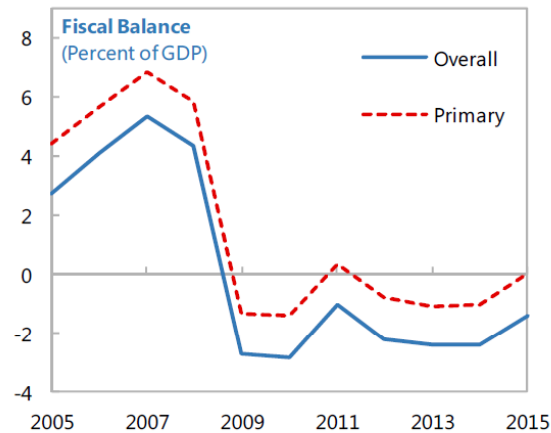
- The competitiveness gap is substantial
- Demand internationally and in Finland is likely to be subdued for the coming years
- The wages in the Eurozone has been increasing with 1,5-2,0 per cent per year and that is also a likely growth rate moving ahead
- Productivity growth in Finland unlikely to be substantially higher than in the Eurozone and other important markets
- The output gap is closing in the years ahead if labour force participation does not increase substantially

Weakness in demand and supply

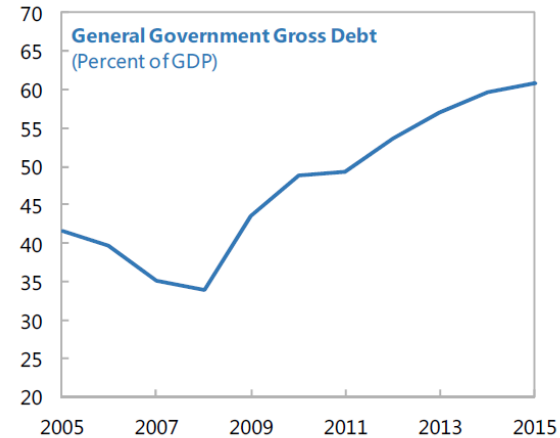
- Export weakness and slack in aggregate demand
- Yet even potential output has hardly grown
- Productivity growth near zero, shrinking labour force
- A combination of a supply shock and demand shock is challenging for economic policy
- If potential growth were strong, fiscal expansion would be less risky
- With weak potential growth, there is no fiscal space

The fiscal space has already been used, long term challenges

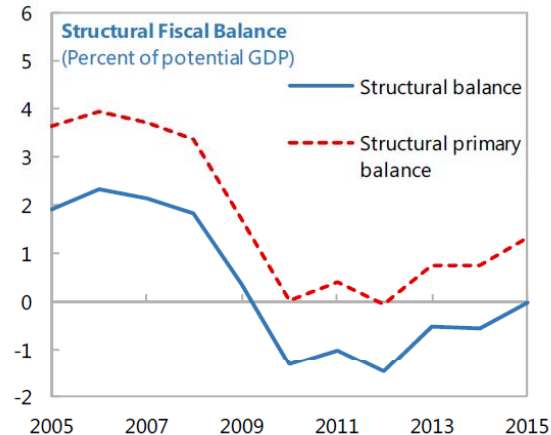
The headline fiscal balance has deteriorated markedly...



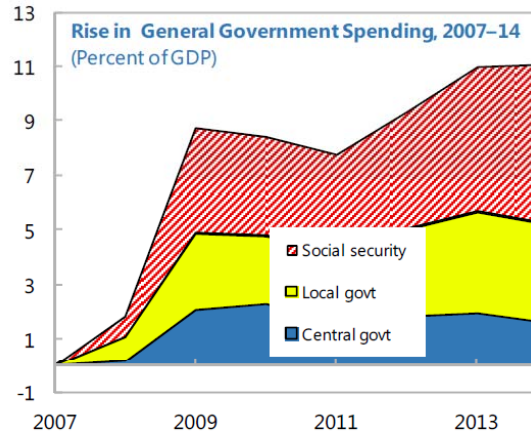
...leading to a substantial rise in debt since 2008.



While the drop in the fiscal balance is partly cyclical, the structural fiscal position has also eroded...



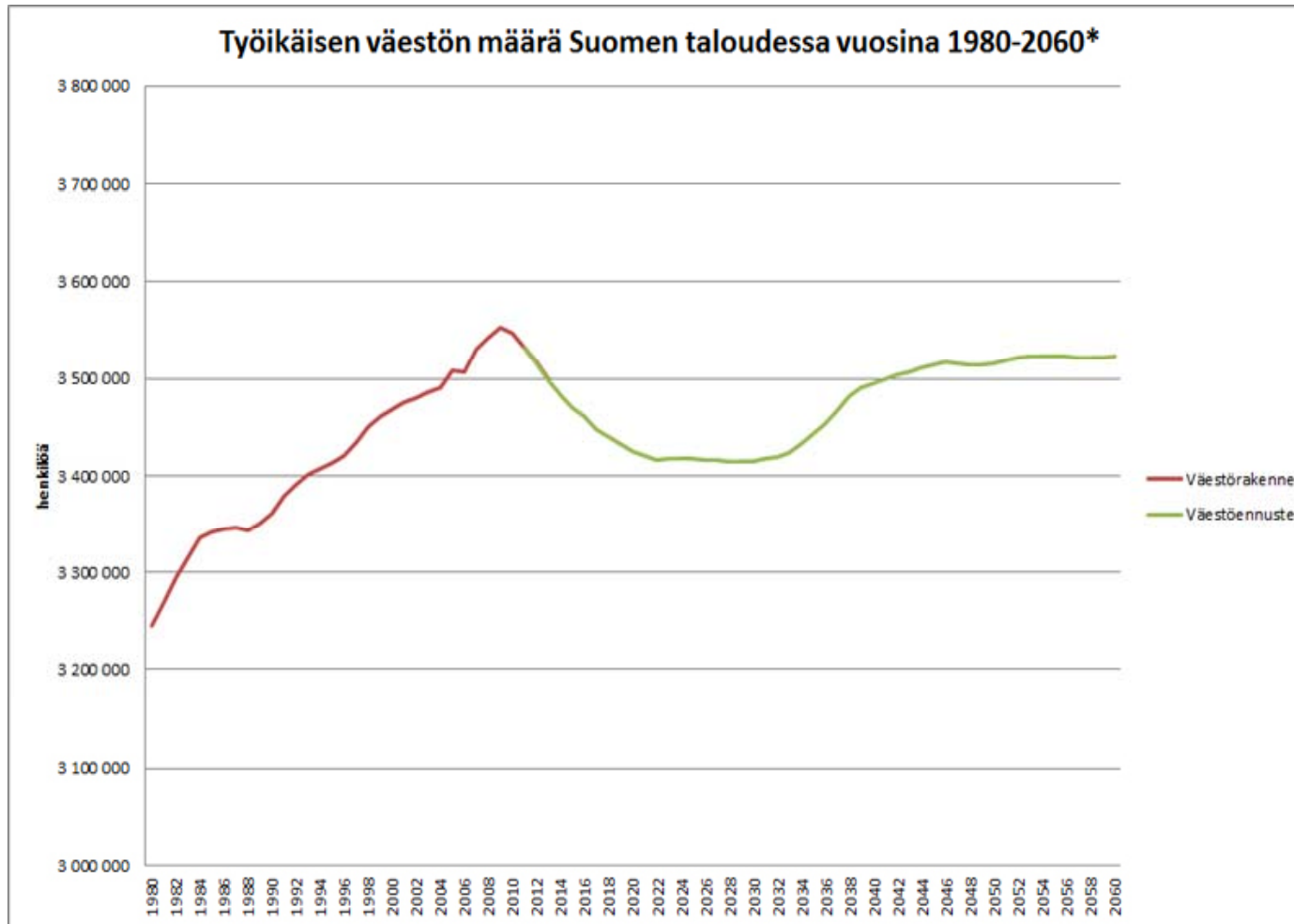
...largely due to sustained increases in social security and local government spending.



Unsustainable public finances

- Sustainability gap 3% - 5% of GDP, depending on the effects of aging
- Business cycle recovery will not suffice to stabilize public finances
- The effects of aging are still mostly ahead of us

Shrinking working age population (15-64)



Conclusions for economic policy?

- The situation is very serious, there is no way around these problems
- There are no easy solutions
 - A global recovery may help but will not solve Finland's problems
 - Finland's cost level is too high
 - Public finances are unsustainable, the current structural level of employment will not sustain the welfare arrangements
 - No fiscal space, there is no purely Keynesian solution

Conclusions for economic policy (2)

- We will present a strategy in our upcoming report
- It will have to achieve the following
 - Regain competitiveness
 - Create positive expectations among investors, firms and households
 - Sustain employment growth for many years
 - Contribute to productivity growth
 - Stabilize public finances
 - Political legitimacy
- A combination of structural reforms, wage setting procedures and fiscal policy?