

Press release

Free for publication on 23 January 2019 at 12 noon

Economic Policy Council

Government's fiscal policy an appropriate response to the business cycle

Despite reduction in government deficit and improvement in employment the sustainability problem remains unchanged. The social and health care reform will not fix this.

The deficit continues to decrease, but from a long run perspective fiscal policy should be tighter

The government has almost reached its fiscal targets. The debt to GDP ratio has started to decrease and public finances will be almost balanced in 2019. The government has implemented the cuts to public expenditure which were planned at the beginning of the term. The 2017 and 2018 tax cuts were poorly timed from a business cycle perspective and the tax decreases over the government's term, which were larger than planned, hinder efforts to stabilize public finances. In 2019 fiscal policy will slightly tighten, which fits the current phase of the business cycle. Public finances will, however, remain structurally imbalanced, and without new measures the debt to GDP ratio will begin to increase in the medium term.

The sustainability gap has not been covered, long-term problems left to the next government

The decrease in the structural deficit has improved the long run sustainability of public finances. Methodological changes have however increased the sustainability gap estimate. By the most recent assessment by the Ministry of Finance, the sustainability gap is about 4 percent relative to GDP, which is one percentage point less than at the beginning of the government's term.

The employment outlook underlying the sustainability gap assessment is pessimistic. If recent employment growth turns out to be permanent, the sustainability gap will decrease. The sustainability gap assessment does not include the possible effects of the ongoing social and health care reform. It is likely, however, that this reform will not decrease the sustainability gap as much as is hoped.

The government's employment target was reached at the end of 2018

Employment has increased rapidly during the government's term. External demand has contributed to employment, but government's policies have also been consistently supportive of employment growth. The effect of government's actions on employment growth is likely to have been significant, even if the exact magnitude of the contribution is impossible to estimate.

Effects of the social and health care reform remain uncertain

The aims of the social and health care reform are ambitious, but in light of research its effects are uncertain. There continue to be no credible evaluations of how the reform will increase productivity to the degree that the savings target could be achieved without compromising quality or access.

Central questions concerning the implementation of the reform remains unsolved. The informational basis required for designing provider compensation models remains inadequate. Leaving occupational health care outside the reform makes designing compensation models more difficult and may increase costs. Some of the reform's risks could be avoided with a more gradual expansion of freedom of choice.

The culture of policy experimentation requires discipline

The government has implemented numerous experiments in sectors such as social security, employment policy, and social and health care. From a perspective of impact evaluation the design of the experiments leaves room for improvement. Learning from the experiments requires that the group participating in the experiment has a well-defined control group. The policies included in the experiments should be clearly delineated and also feasible as actual reforms. Better designed experiments would facilitate their use in supporting political decision making. Also possibilities for ex-post evaluation of reforms should be taken into account already in the legislative phase.

Further information:

Roope Uusitalo, Chairman of the Economic Policy Council

roope.uusitalo@helsinki.fi, tel.: +358 40 805 4863

Seppo Orjasniemi, Secretary of the Economic Policy Council

seppo.orjasniemi@vatt.fi, tel.: +358 295 519 412

Report (available from 12 noon, 23 January 2019):

www.talouspolitiikanarviointineuvosto.fi

The Economic Policy Council was founded in 2014 to impartially evaluate the aims and methods of economic policy. The chairman of the Economic Policy Council is Professor **Roope Uusitalo**. The other members are Professor **Torben M. Andersen**, Professor **Anneli Anttonen**, Professor **Kaisa Kotakorpi**, and Professor **Mikko Puhakka**.