

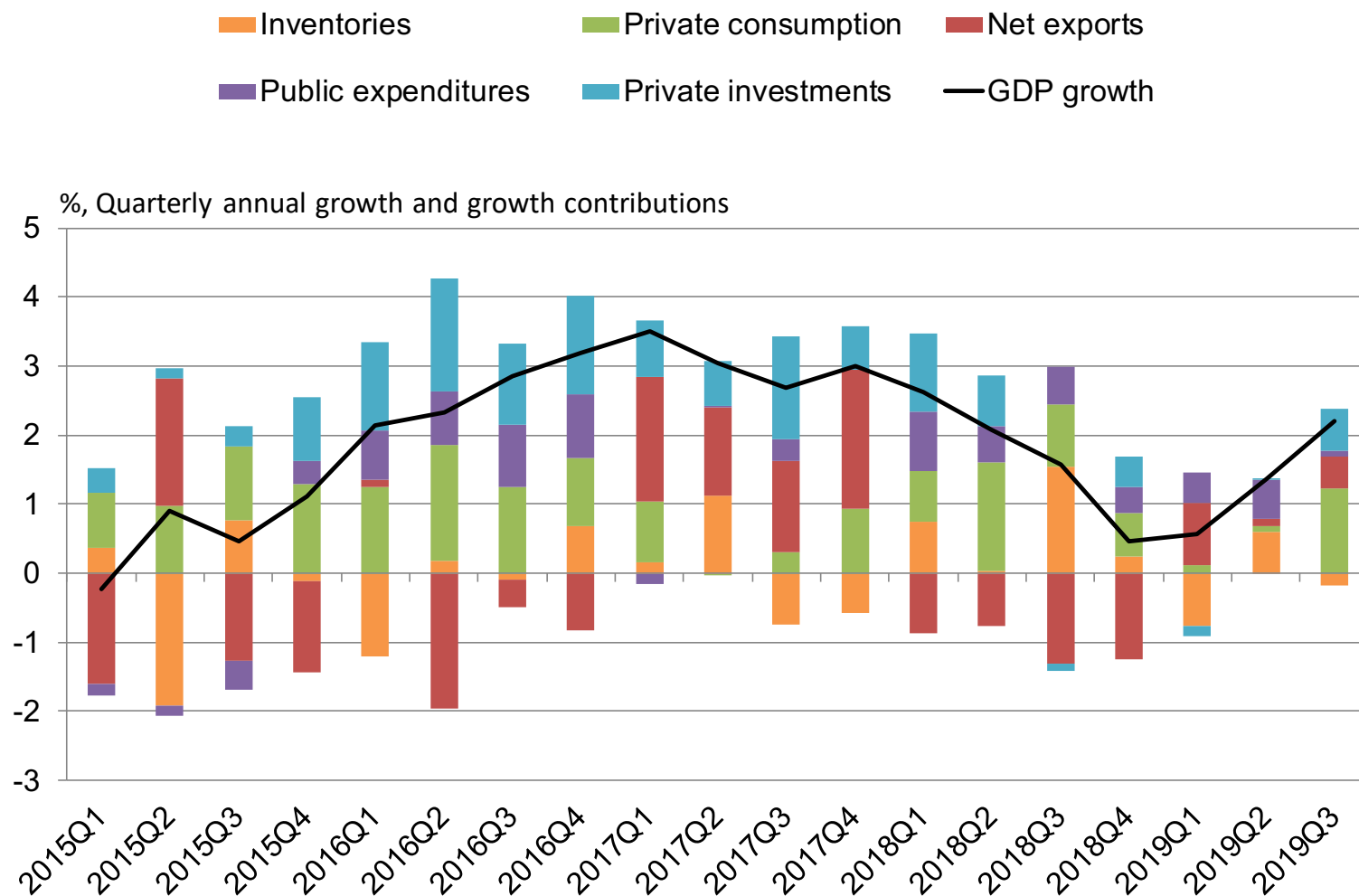
Economic Policy Council Report

January 2020

Professor Martin Ellison
University of Oxford

Recent economic developments

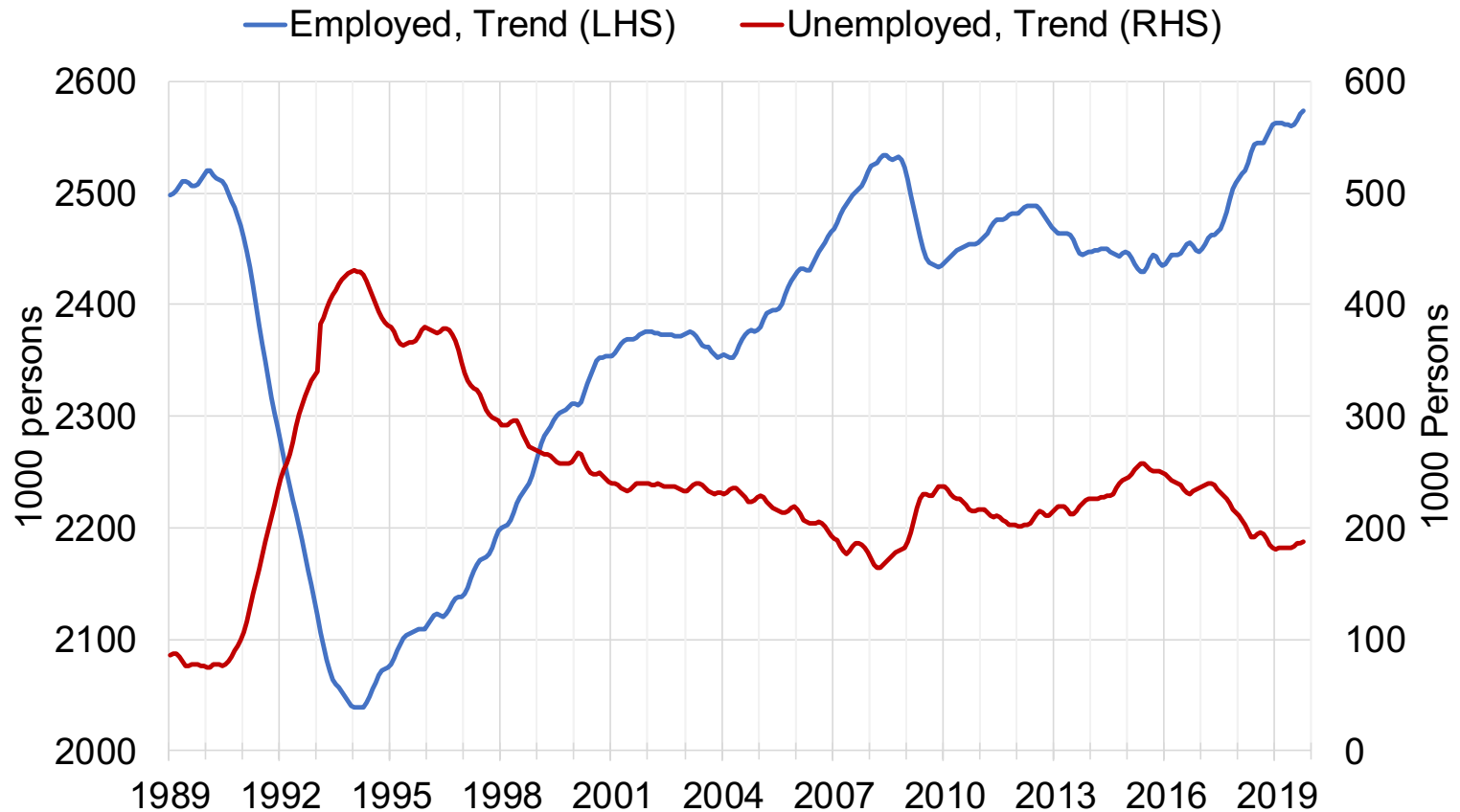
GDP growth gathered pace in 2019



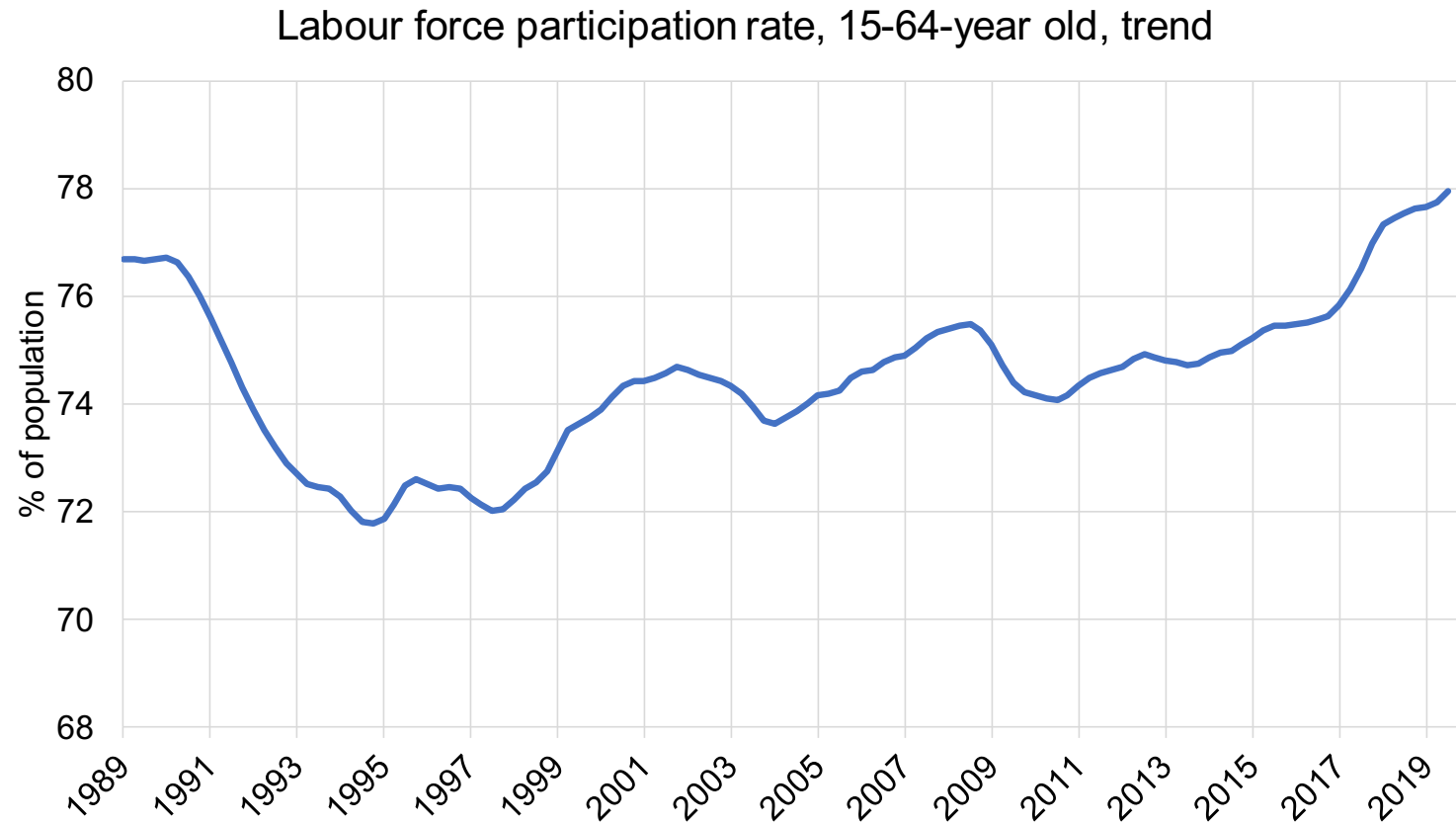
GDP growth forecast to slow in 2020 and beyond

		2019	2020	2021	2022	2023	2024
Bank of Finland	17 Dec	1.3	0.9	1.1	1.3		
Ministry of Finance	18 Dec	1.6	1.0	1.1	1.2	1.0	0.9
OECD	8 Nov	1.3	1.0	0.9			
European Commission	7 Nov	1.4	1.1	1.0			
IMF	7 Oct	1.2	1.5	1.5	1.4	1.3	
PT	17 Sep	1.3	1.1				
ETLA	16 Sep	1.1	0.9	1.1			
PTT	12 Sep	1.3	1.2				

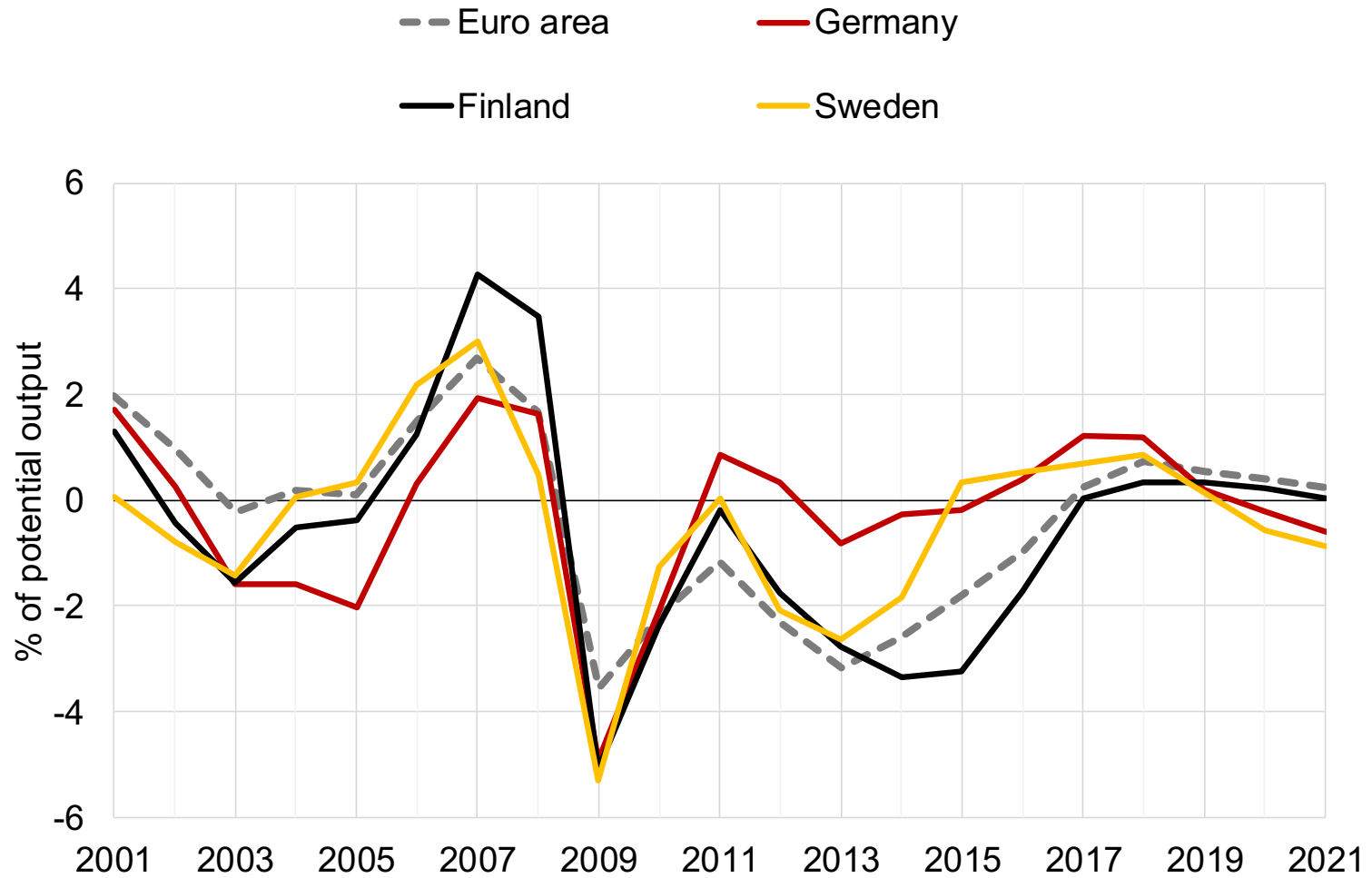
Employment \uparrow and unemployment \downarrow



Labour force participation ↑



GDP \approx potential GDP

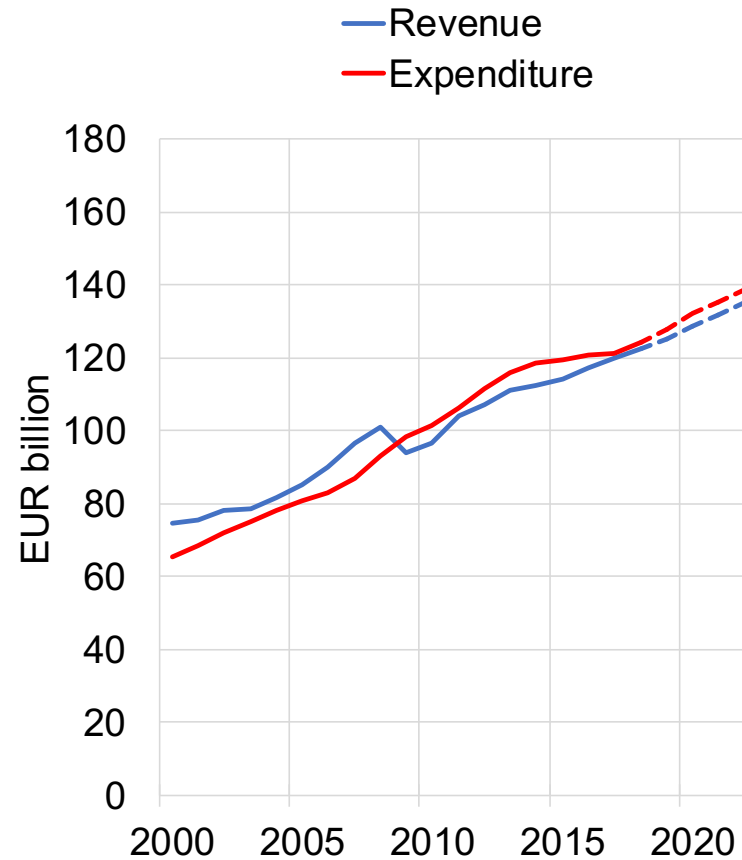


Council views on recent economic developments

- High growth rates not expected to continue
- Growth falls to about 1% in 2020 and afterwards
- Labour force participation high
- Unemployment at long-run level
- Finnish output gap $\approx > 0$
- Economic cycle cooling in EU

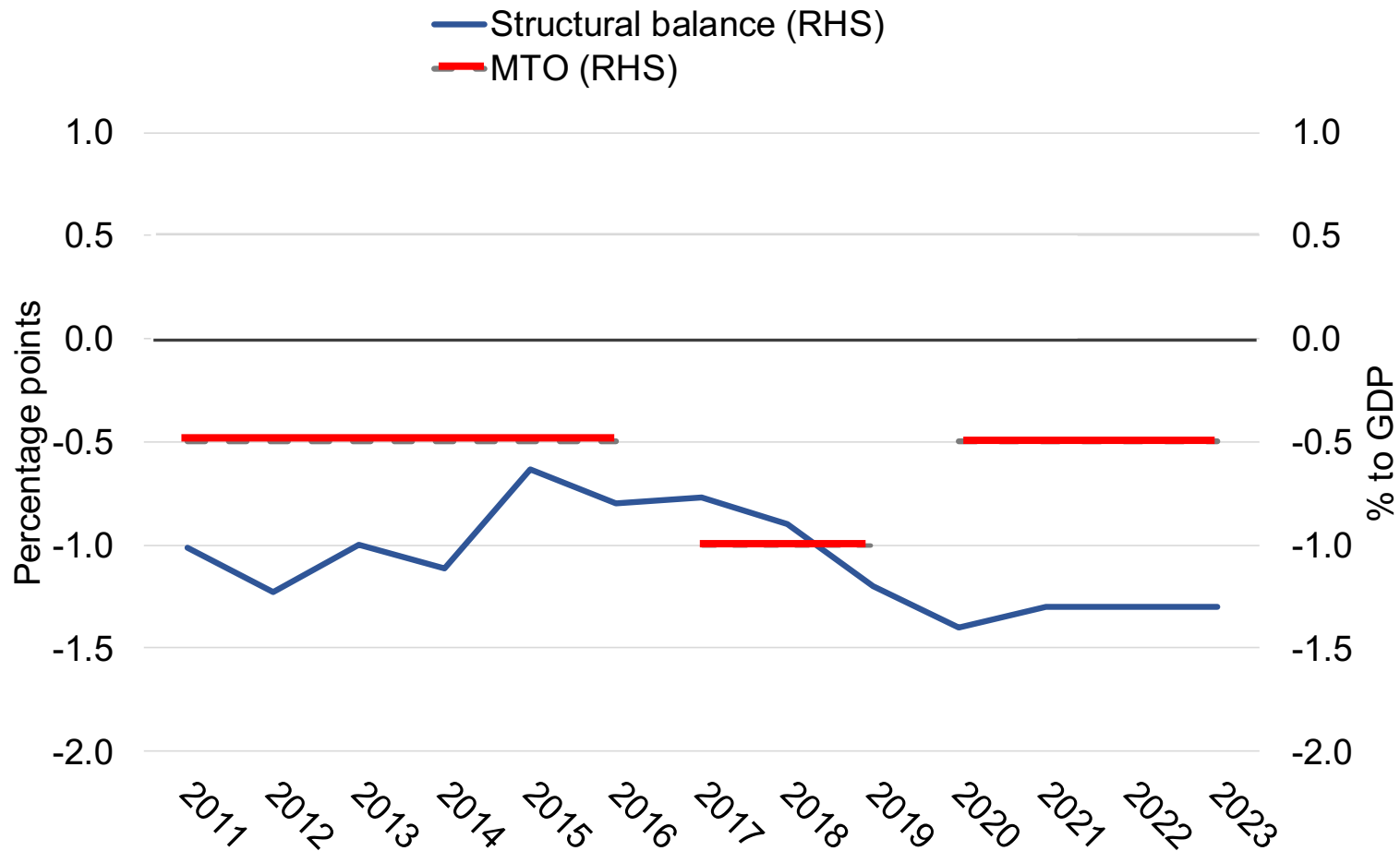
Fiscal policy

General government finances in deficit



Sources: Statistics Finland and Ministry of Finance Winter Forecasts 2019

Central government structural deficit too high



Source: Ministry of Finance Autumn Forecasts 2019

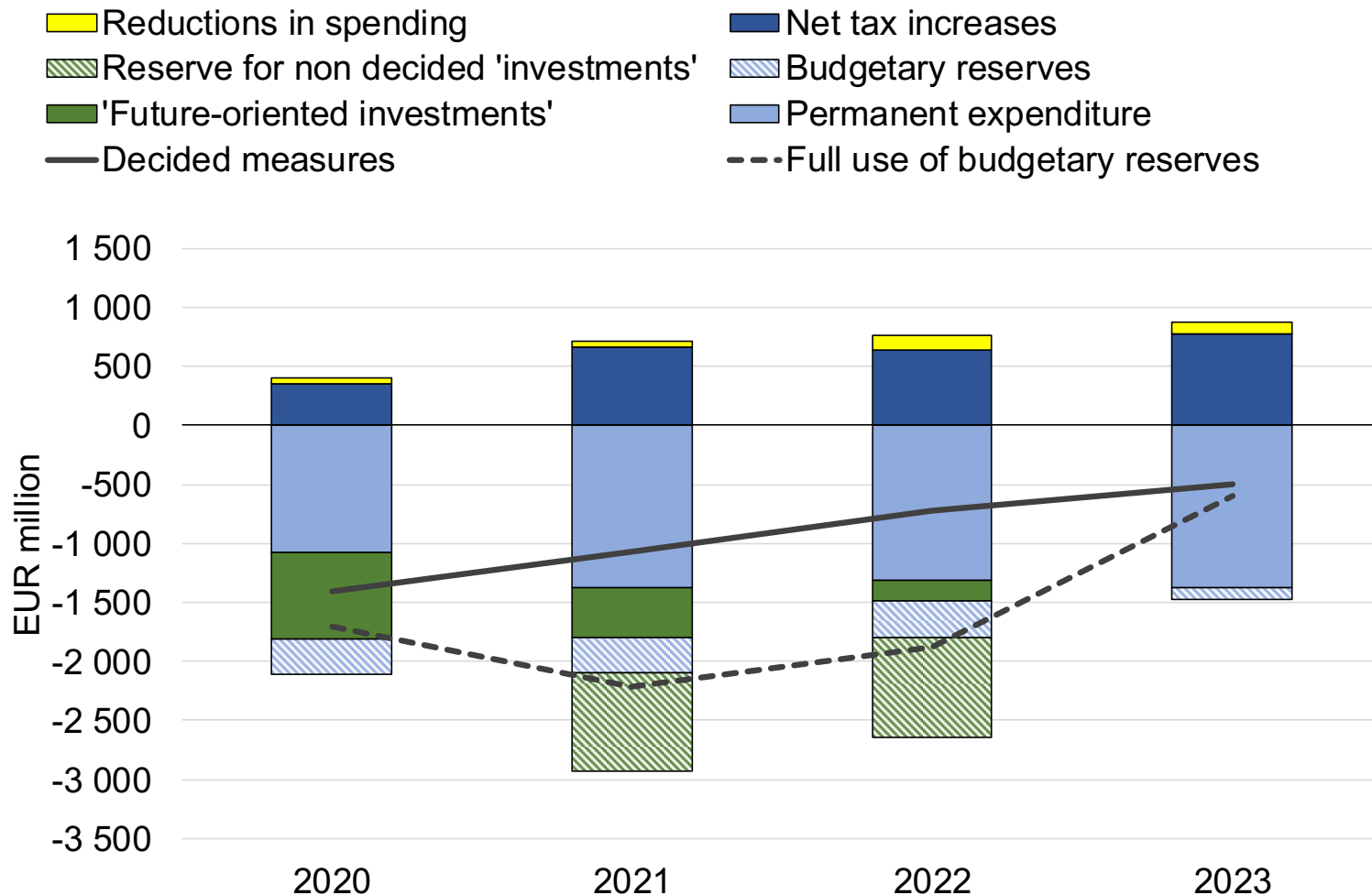
Finland and the EC

- Structural deficit in 2020-23 \approx -1.3% to -1.4%
- Higher than Medium-Term Budgetary Objective (MTO) of -0.5%
- Government spending in 2020 \uparrow faster than reference rate
- Debt/GDP likely to exceed 60% limit in Stability and Growth Pact
- EC will require Finland to take preventative measures if economic developments follow forecasts

Discretionary fiscal measures

- €1.4 billion permanent ↑ in spending by 2023
- €0.8 billion ↑ in net taxes by 2023
- Gap funded by ↑ in tax revenue from ↑ in employment
- Spending front-loaded to start in 2020
- Tax revenue ↑ gradually towards 2023
- Up to €3 billion future-oriented investments in 2020-22
- Funded by selling up to €1.5 billion of financial assets
- Spending “assessed” if measures to ↑ employment not in place by August 2020

Discretionary measures worsen the deficit



Source: Ministry of Finance Autumn Forecasts 2019

↑ in employment?

- Employment target of 75% \approx 60,000 new jobs by 2023
- Unemployment target of 4.8% for 2023
- 4/5 from unemployment ↓ and 1/5 from participation ↑
- Difficult to reduce unemployment below natural rate
- Vacancies already very high
- Mismatch more sectoral than regional
- What are policies to ↑ employment?

↑ in tax revenue from ↑ in employment?

- Depends on quality and type of jobs created
- Part vs full time
- Private vs public sector
- Difficult to be certain of fiscal implications
- Hard to know how many new job measures will be created, so difficult to know if spending should be “assessed” in August 2020
- Government has made realistic assumptions

Future-oriented investments

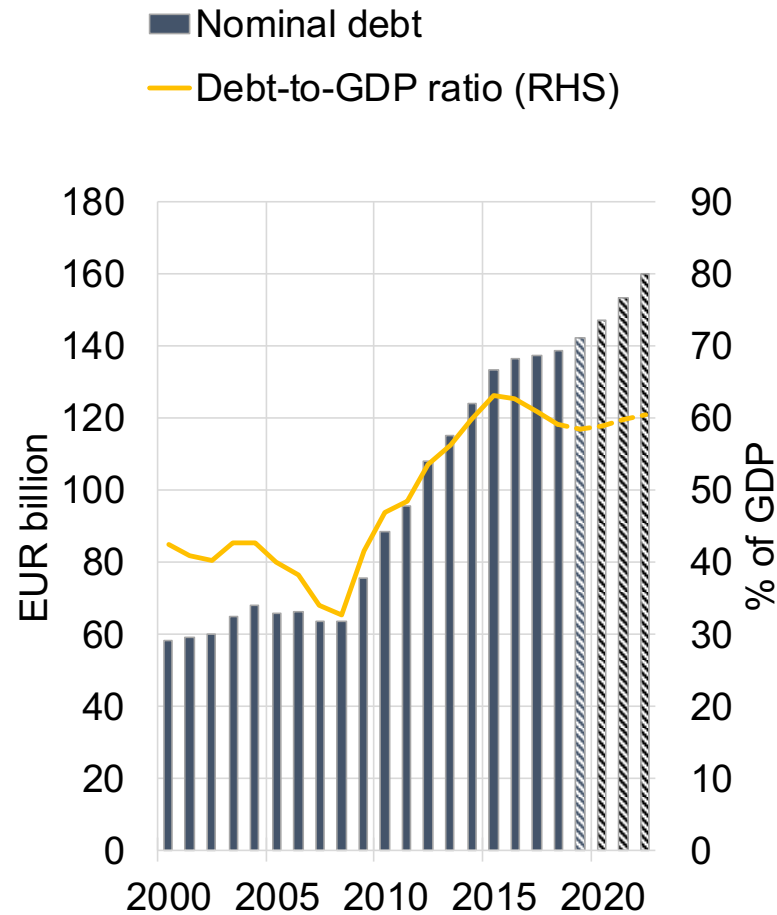
- Miscellaneous collection of 85 separate items for 2020
- Many not real investments, e.g. €42 million in 2020 to less favoured areas to 'ensure that agricultural production continues in Finland'
- Many really require permanent funding, e.g. €235 million in 2020-22 for extra students/counsellors in vocational education
- Why fund by selling government assets?

Council views on fiscal policy

- Fiscal policy too loose
- Finland will breach EC rules 2020-23
- Need a plan how to balance government budget
- Deficit \uparrow when output gap ≈ 0 inappropriate and reduces future fiscal space
- Future-oriented investments poorly designed
- Very difficult to condition on employment measures

Fiscal sustainability

Debt/GDP will be 60% but ↑ in 2023

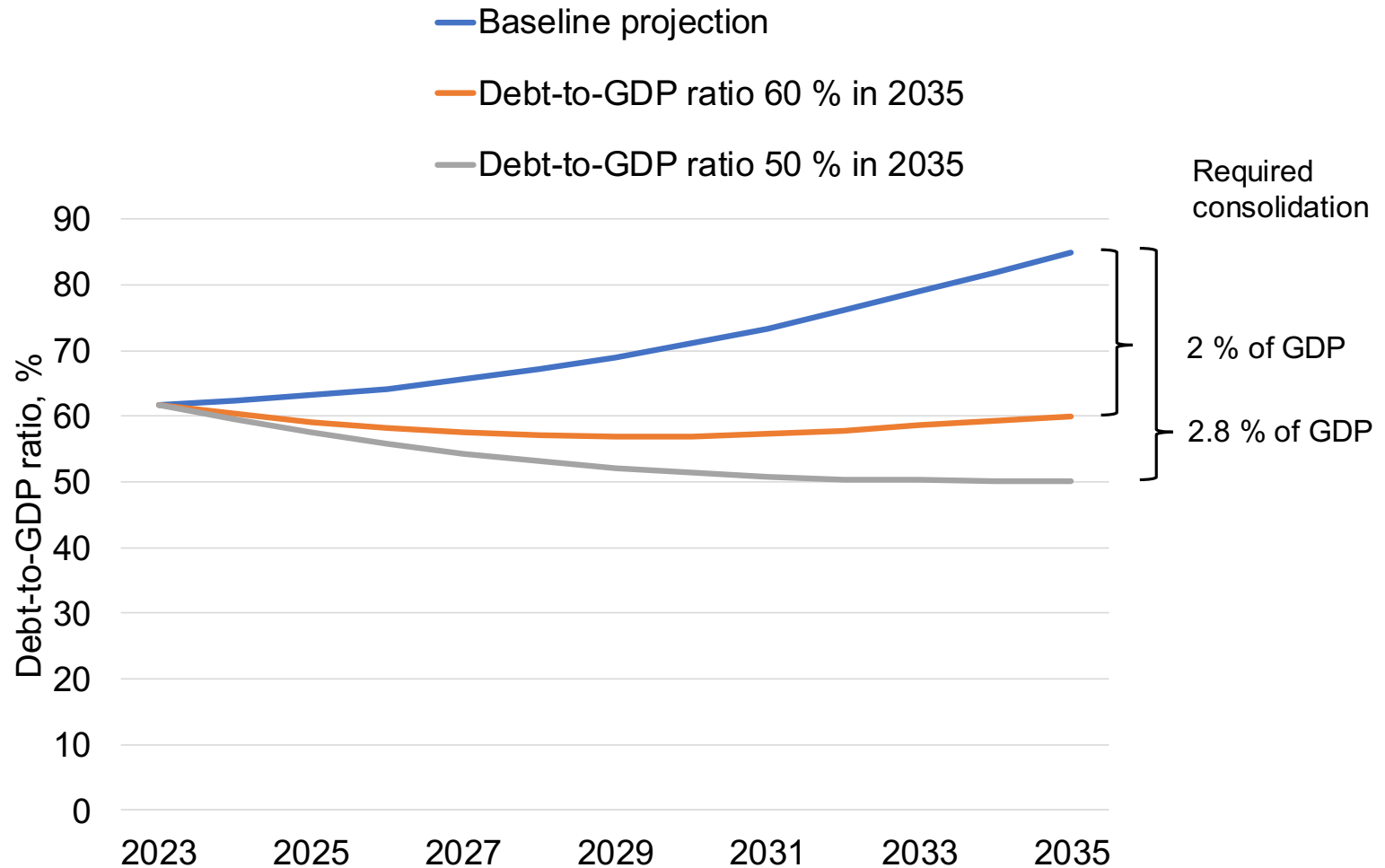


Sources: Statistics Finland and Ministry of Finance Winter Forecasts 2019

Downside fiscal risks are pervasive

- Will employment target be achieved?
- Will \uparrow in employment lead to \uparrow in tax revenue?
- Will future-oriented investments be temporary?
- Interest rate and exchange rate risk
- Risk from central government guarantees (24% of GDP in 2018)

Debt/GDP ↑ after 2023



Sources: EPC calculations based on the sustainability assessment by Ministry of Finance August 2019

Sustainability gap

- $\approx 5\%$ of GDP
- Finland is an ageing country
- \uparrow fertility not enough
- \uparrow employment helps
- Provided tax revenue \uparrow and used wisely
- Selling government financial assets does not help

Council views on fiscal sustainability

- Finland has a big long-run sustainability problem
- Medium-term plan needed to permanently lower budget deficit
- Debt/GDP to 2023 increasing even if policies successful
- Downside fiscal risks pervasive
- Need to put public finances on sustainable path after 2023

Press release 2020

LOOSE FISCAL POLICY LACKS A PROPER PLAN FOR SUSTAINABILITY

- Fiscal policy is too loose
- Employment target is useful but blunt instrument
- Large sustainability problem in medium-term
- Proper plan for fiscal sustainability needed
- Composition and financing of public spending needs to improve

Same old ... same old ...

2020



LOOSE FISCAL POLICY LACKS A
PROPER PLAN FOR SUSTAINABILITY

2018



FISCAL POLICY TOO LOOSE IN THE
CURRENT ECONOMIC SITUATION