

Comments on the Economic Policy Council's 2019 Report

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Outline

1. The Finnish Economic Council
2. Finland's economic-policy problems in a Nordic perspective
3. Fiscal policy in a medium-term perspective
4. The relationship between employment and fiscal targets
5. The council's analysis of long-run fiscal sustainability

Economic Policy Council in Finland

- Broad remit – not only fiscal policy
- High standards
 - independence
 - qualification requirements
 - appointment procedures
- But insufficient resources: perhaps pool resources of EPC and NAOF
- Reports of high quality
- Valuable input into the economic-policy discussion
- But uneven level of abstraction in reports
 - some parts are not so accessible to a wider audience
 - advice: separate better between parts for a wider audience and parts for specialists

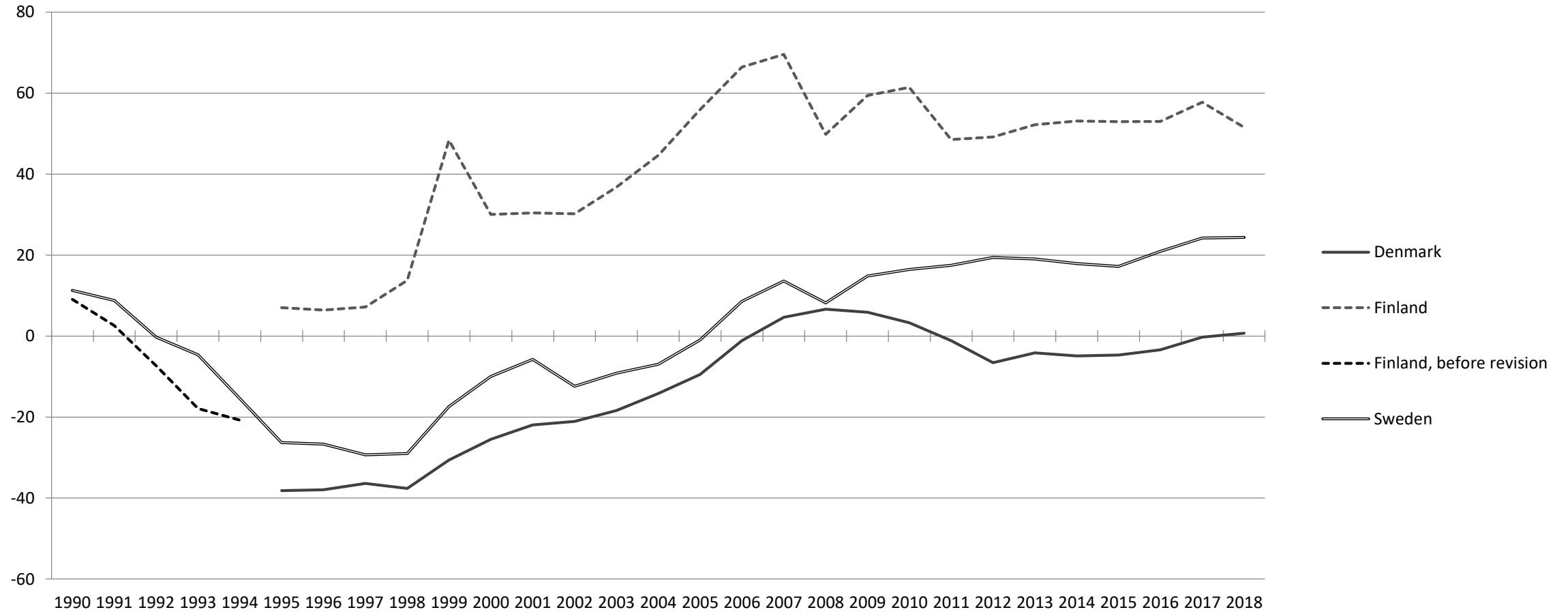
General government fiscal balance, percent of GDP



Maastricht debt, percent of GDP



General government net financial wealth, percent of GDP

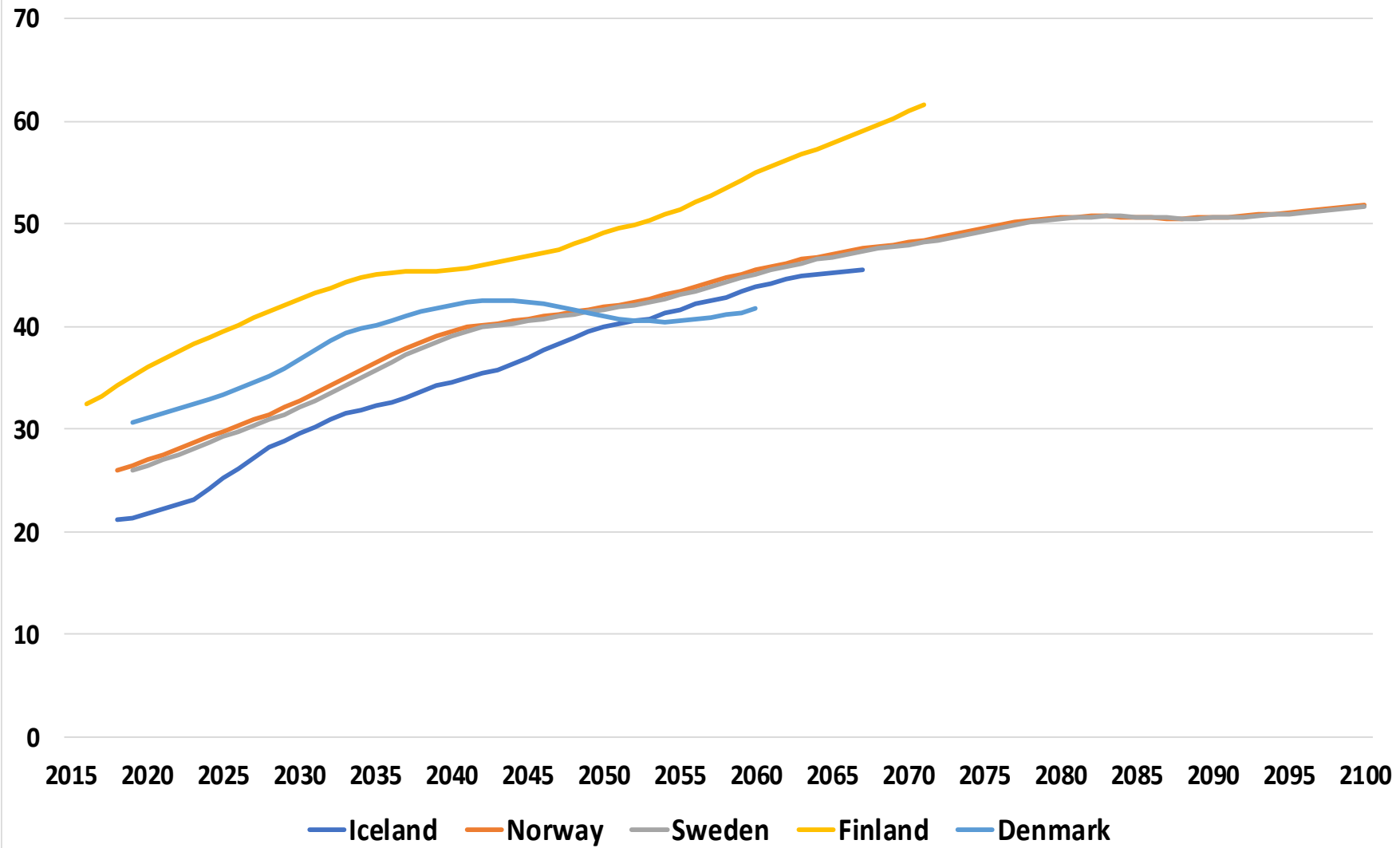


S2 sustainability indicator

Denmark	-1 – -2
Finland	3 – 5
Sweden	-1 – 1

Figure 3b: Elderly dependency ratio, 2015 to 2100

(65 and older as share of 15 to 64)



Fiscal targets and forecasts

Targets

- Medium-term objective (MTO): Maximum structural deficit of 0.5% of GDP
- Government target: zero (nominal) fiscal balance in 2023

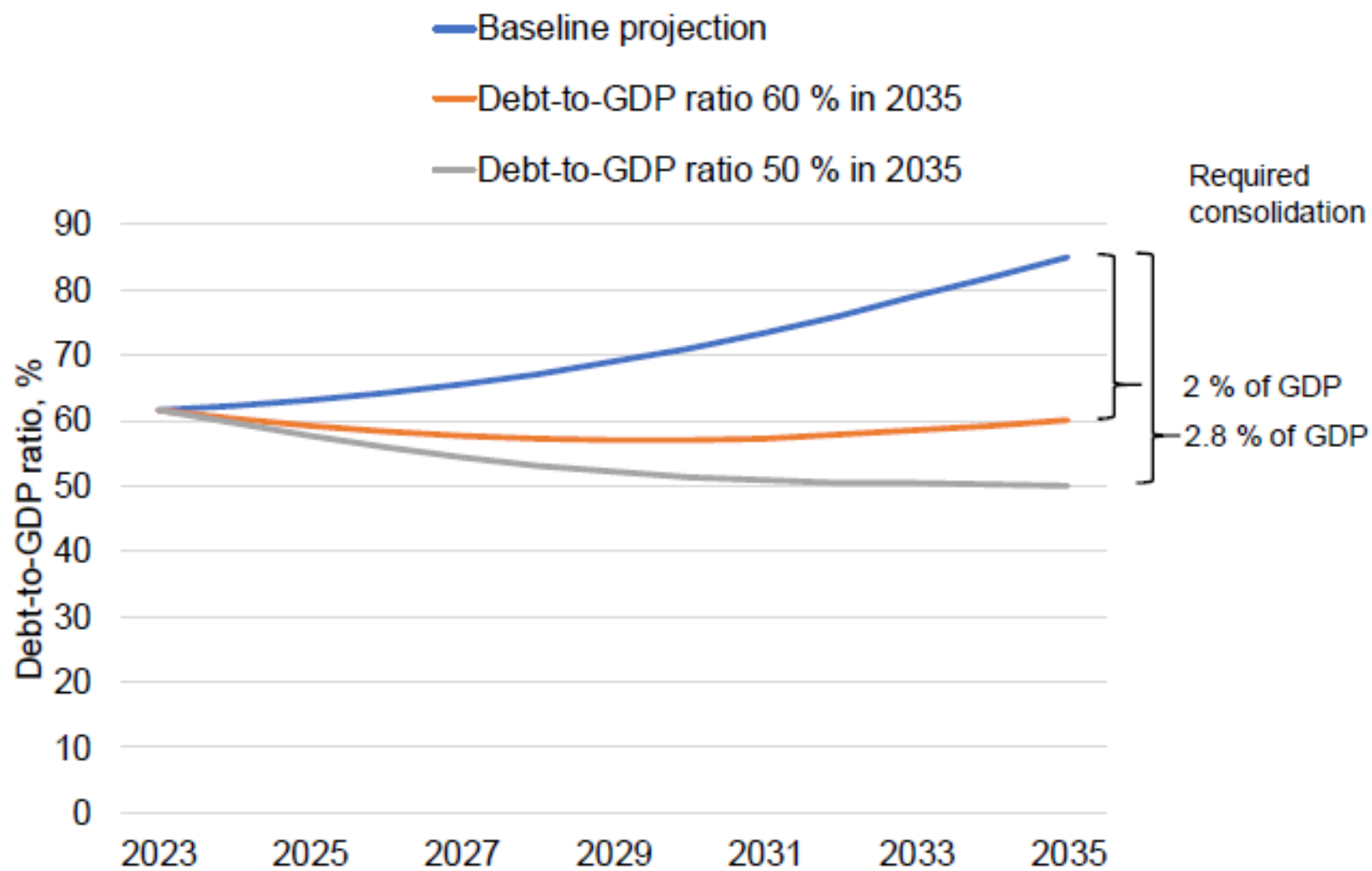
Forecasts

- Structural deficit of 1.3% of GDP in 2023
- Nominal fiscal deficit of 1.2% of GDP in 2023
- Expenditure on fighter jets not included

Discrepancy between forecasts and targets

- Government expenditure increases
- The government hopes to cover the discrepancy through higher revenues (and lower expenditure) from employment increases
- The council is concerned that EU rules will be violated
- Wrong timing from a stabilisation policy point of view

Figure 5.3.1. Debt-to-GDP ratio is projected to grow in the medium run.



Negative interest-growth differential

- Debt can "pay for itself"
- Debt-to-GDP ratio can fall also with primary deficits (if not too large)
- Argument has some merit in Denmark and Sweden with low debt ratios
- Dangerous argument for Finland
- Bond yields rise with debt above threshold
- Risk of snowball effect
- Fiscal fatigue threshold?

Other aspects of fiscal policy

- Expenditure increases are financed by sales of financial assets
 - Financial-asset sales and government borrowing affect net financial wealth in identical ways
- The future-oriented investment programme
 - All is not investment
- Escape clause for spending limit (expenditure ceiling)
 - exceptional situation

The government's labour-market targets

- Target for employment rate of 75% in 2023
- Target for unemployment rate of 4.8% in 2023
- Key element in the government's plan to meet the fiscal targets

Fiscal impact of higher employment according to the council

- *Back-of-envelope calculation*: 1 percentage point higher employment rate improves primary balance by 0.8% of GDP
- *Microsimulation*: 1 percentage point higher employment rate improves primary balance by 0.4% of GDP
- *Sustainability-gap calculation*: 1 percentage point higher employment rate improves sustainability indicator by 0.4% of GDP

Problems with calculations

- Increase in employment is not an *exogenous* event
- Instead, it is an *endogenous* response to policy

Differential fiscal effects depending on employment policy

- Less generous benefits
 - lower unemployment benefits
 - more restricted access to unemployment benefits
 - more restricted access to early retirement
 - higher retirement age
- Earned income tax credit
 - Sweden: only 20-30% of static revenue loss offset by dynamic gains
- Employment subsidy
 - uncertainty regarding crowding-out effects on non-subsidised employment

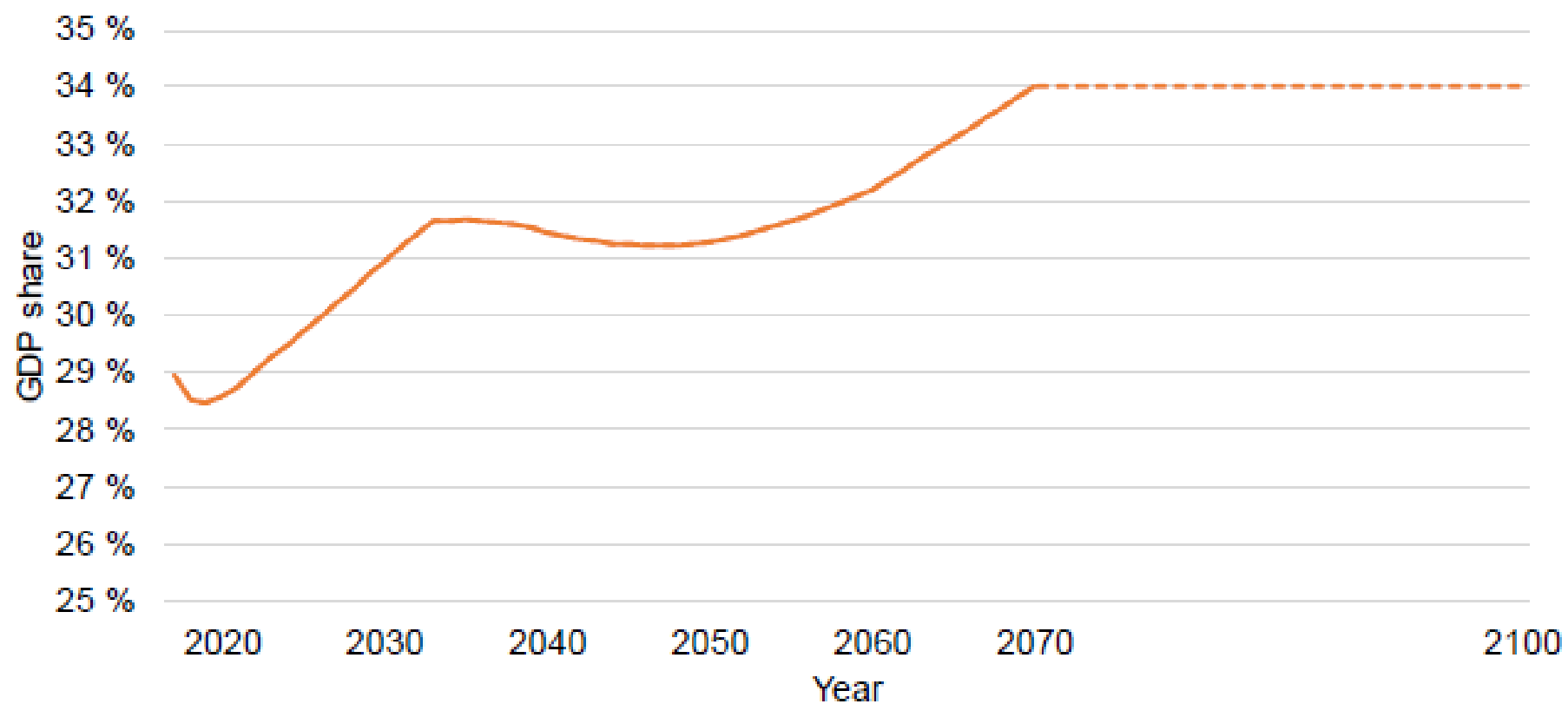
Fiscal policy and employment policy

- Expenditure increases are conditioned on employment policy
 - conditioning on ex-ante assessment of effects according to council
- Problems with assessment
 - definition of employment-policy measure
 - does employment change depend on these measures or on something else?
 - fiscal impact of employment measure?
- Unnecessary complications
 - all that is required is comparisons of good fiscal forecasts with fiscal targets

Fertility and the sustainability indicator

- Alternative scenario with fertility rate of 1.2 instead of 1.45
- Small effect (0.3% of GDP) with time horizon till 2070

Figure 5.4.2. Evolution of the GDP share of age-related expenditures in the SOME model.



Fertility and the sustainability indicator

- Alternative scenario with fertility rate of 1.2 instead of 1.45
- Small effect (0.3% of GDP) with time horizon till 2070
- Impact is doubled (to 0.6% of GDP) if time horizon is lengthened to 2085
 - full account of effect of smaller labour force
- But time horizon should be lengthened even longer
 - to take into account that number of pensioners ultimately fall, too
- Likely zero effect in the very long run
- Cf analysis for Norway by Statistics Norway

Main conclusions

1. High-quality work by the Economic Policy Council
 - but analysis of link between employment policy and fiscal policy could be sharpened
2. Finland has a large fiscal sustainability problem
 - current policy does not appear well designed to address this problem

Caveat: This is an outsider's view

But: Hard for an outsider to come to any other conclusion