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Economic Policy 2015-2019

Ministry of Finance's official overview

Key Messages

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INTRODUCTION

This is the Ministry of Finance's official overview of Finland's key challenges in terms of economic policy, and the required actions. The timeline is the electoral period of 2015 to 2019. Besides traditional economic policy, the report discusses public governance and the financial markets. The public finances are discussed as a whole.

With respect to economic development, Finland's situation remains difficult and the economy is recovering slowly. Whilst the public sector enables sustainable development, it cannot function as a source of growth. Key methods of improving the prospects for growth include the structural reform of Finland's economy, the promotion of competition, the achievement of greater efficiency in the public sector and wage moderation.

Public services – particularly social welfare and health care services – can be rendered more efficient through economies of scale achieved on the basis of cross-municipal solutions and larger municipalities. Our degree of success in this will determine Finland's future economic resilience and the development of service quality.

This report was created under the supervision of Markus Sovala, Director General of the Economics Department, and was jointly prepared by all of the departments within the Ministry of Finance. Senior civil servants at the Ministry have outlined the key messages and conclusions, i.e. sections 1 and 2 of the main report. The background sections 3–10, which discuss issues such as the objective of financial policy; employment; taxation; and administration, were written by experts at the Ministry. Outi Honkatukia, Senior Adviser, was responsible for preparing the report for publication.

The report is published under the responsibility of the ministry's officials and has not been discussed, reviewed or endorsed at political level.

This partial report includes the key messages i.e. section 1 of the main report. The main report (in Finnish) was published on 19 March 2015. The report can be downloaded from the Ministry of Finance's website, vm.fi.

1 Key messages

In economic policy, the key challenge has been setting economic growth on a sustainable but more positive upward trajectory than it has followed in recent years. To achieve this, we must change employment and productivity trends for the better. Success in this will be crucial to stabilising Finland's public finances.

However, in managing its public finances, Finland cannot rely on optimistic expectations. The Ministry of Finance's Economics Department forecasts average economic growth of no more than around 1% over the next few years. The services and benefits provided by the welfare state must be planned accordingly.

At this rate, the deficit-to-GDP ratio for state and municipal finances is likely to remain at around 3%, and the public-debt-to-GDP ratio may rise to nearly 70% of GDP. Reducing the deficit and the debt ratio will require new adjustment measures.

The sustainability gap in Finland's public finances is estimated to be around 5% of GDP, presuming that pension reform is implemented as agreed in the autumn of 2014. This sustainability gap is larger than previously estimated, due to an expected deterioration in the structural deficit in the public finances at the end of the forthcoming electoral period.

Estimates suggest that adjustment measures equivalent to 6 billion euros will be required by 2019 in order to enable a reduction in the public finances' debt-to-GDP ratio during the next electoral period. Adjustment measures of this level could almost restore the balance of the state and municipal finances.

Eliminating the calculated sustainability gap in the public finances will require structural reform in addition to rapidly effective adjustment measures.

The structural deficit in the state and municipal finances could be eliminated either through adjustment measures (i.e. cost cutting and tax rises) or structural reform. For instance, ensuring the realisation of productivity benefits in the social welfare and health care sector through a binding cost framework would not be a traditional adjustment measure; nonetheless, on the public expenses it would have an effect similar to cost-cutting.

The public finances must be controlled through clear rules on expenses and taxation:

- The adjustments to be made in the spending limits for state finances should be determined by an expense rule in the Government Programme.
- Any effects of structural reform should be taken into consideration only as a factor reducing the need for adjustment measures, and only on the basis of calculations approved by the Ministry of Finance.
- A taxation rule should ensure the effect of changes in the tax basis in the same manner as the expense framework currently does.
- Municipal adjustment measures should be based on the elimination of tasks and obligations and improvement in the efficiency of activities. Tasks must be planned so that they can be funded without increasing local taxation.

Structural reform must be decided upon during the budget process. The Government must outline the objectives for the preparation of reform within ministries on an annual basis, when the preparation of the General Government Fiscal Plan begins.

The following measures are required in order to promote employment, investment activities and productivity:

- Long-term wage moderation
- After balance is restored, the permanent adoption of a wage practice that determines rises in salaries in accordance with the inflation objective and productivity development in the open sector
- Improved incentives to work or run a business; housing policies and the elimination of bureaucratic pitfalls could be applied in this context
- A stable environment for economic life and entrepreneurship

The adjustment measures must be clearly focused on expenses, because employment objectives prevent any increase in overall taxation. However, the taxation structure could be adjusted to favour work and promote growth. Any tax relief should be focused on the taxation of labour.

Increasing employment requires that measures be taken to boost supply and demand for labour. Regional and professional mobility of the work force must be promoted through labour policy, social policy and housing policy.

Further incentives to work can be created by aligning taxation with social security and by eliminating bureaucratic pitfalls. The level of and conditions for various benefits must be examined from the viewpoint of employment. However, extensive social security and progressive taxation restrict the potential for eliminating bottlenecks related to incentives. It is imperative that working is financially rewarding.

Activation measures related to labour policy must be aligned with benefits legislation and planned so that they support employment and professional mobility. As a counterbalance to benefits, it must be possible to require participation in activities that maintain and develop professional skills.

Digitalisation – reforming both practices and information technology – should be used to promote the following:

- improvement of services and introduction of new business opportunities
- improvement of the productivity and competitiveness of businesses
- improvement of productivity in the public sector.

Digitalisation of public administration services, i.e. the adaptation of electronic processes, can be used to improve the availability of services and lessen the administrative burden on companies and citizens. Electronic services should be the primary form of service.

Digitalisation of public services has been hampered by the slow progress of collaboration between authorities. Aligning service processes and administration is often more challenging than implementing the required ICT solutions. The national data exchange layer supports the development of new services and business opportunities.

The promotion of digitalisation and the development of administration are closely interrelated. Because they are so important to improving the productivity of services, and therefore to adjusting public expenses, the development and coordination of public administration and its ICT activities should remain the responsibility of a single ministry. To realise savings, such work should be closely linked with the General Government Fiscal Plan and thus the local government financial programme. Seamless collaboration between the ministries in charge is required in order to ensure the efficient promotion of digitalisation and thus to improve the productivity and competitiveness of the national economy.

The internationalisation of growth companies in Finland has been slow. Companies' prospects of entering the global market should be enhanced, and a culture of entrepreneurship must be promoted. In order to improve productivity, the skills and degree of risk-taking of growth companies could be increased by developing the services and financial instruments provided by financial institutions.

In the preparation of social welfare and health care reform, discussion has largely focused on a single-tier model involving federations of municipalities. In further preparations, consideration should also be given to a two-tier administrative model and the possibilities of transferring responsibility for organising and financing services to the state. As a result, tasks unrelated to social welfare and health care would also be examined, as would the entire financing system for services.

The starting point for further preparations must be restraining the increase in social welfare and health care expenses resulting from the change in the population's age structure. Any needs for further structural reform of the public administration must be taken into consideration during the planning of reform. However, the creation of a social welfare and health care budget framework cannot wait until more extensive reform is in place. Such a framework will be needed regardless of the administrative model applied. Without a budget framework, we cannot count on being able, to any notable degree, to restrain the increase in social welfare and health care costs during the next electoral period.