

## Economic policy – chief points

After almost a decade-long standstill, Finland's economy is finally on an upswing, which is now bolstered by exports, in addition to consumption and construction. However, the medium and long-term economic challenges remain as severe as ever. These are:

- a) Low fiscal sustainability risks,
- b) Employment rate too low,
- c) Insufficient skill levels and ability to innovate

Skill levels and the ability to innovate are crucial for productivity growth and, thus, for the possibility of raising salaries and living standards. Low fiscal sustainability risks are an ever increasing threat to economic growth and to fulfilling the promises of public welfare. The budget deficit is heavily dependent on employment, as well as on expenditure and tax policy. The low employment rate is, in fact, the Achilles heel of the Finnish economy: it is below 70%, while in the rest of the Nordic countries it is around 75%.

These are the issues that our economic policy should be focused on.

### **1. Fiscal sustainability and fiscal policy**

Finland's general government finances are still showing a deficit, as they have going back as far as 2009. For the foreseeable future, the structural deficit will not be reduced and fiscal sustainability will not be improved at all, and leaving them to their own devices will not improve the situation. Over time, the continually growing general government debt may erode the conditions for economic growth and make the economy more vulnerable to crises. At the same time, it will reduce the public sector's ability to perform its duties and distort the distribution of income between generations.

Finland is enjoying an upswing and may perhaps soon experience a period of economic prosperity. Both the perspective of economic trends and the need to improve fiscal sustainability advocate a tightened rather than lightened fiscal policy: now is the time to accumulate buffers for a rainy day and decrease the structural deficit.

The line of a neutral fiscal policy can be defended with the need to facilitate structural changes and with the fact that the growth phase has only just started. There are no grounds for fiscal stimulus: instead, expenditure increases should be avoided and any tax reductions should be financed by cutting expenses proportionally. In light of Finland's high tax rate, by international standards, strict expenditure control is required.

### **2. Employment rate**

The best way to improve fiscal sustainability is to raise the employment rate to the level of other Nordic countries. This requires both intense growth of the labour demand over several years and a clear increase of labour supply.

The prerequisite for the growth of labour demand is that labour costs do not rise too much in relation the growth of productivity. We cannot afford to lose the cost competitiveness gained through moderation in wage

developments and the Competitiveness Pact. To raise the employment rate significantly, pay increases must remain lower than in competitor nations for several more years. It is also important to ensure that the rigidity of the wage structure does not prevent access to the labour market for workforce who are less productive, such as immigrants who lack language skills.

The long-term low employment rate in comparison to other Nordic countries indicates that the principal cause for it is Finland's insufficient labour supply. The current boom conditions provide the right time to implement the measures designed to deal with the problem: when there are many vacancies, new people actively participating in the labour market will find work more easily than when demand is low. Now is not the time to ease off on the actions taken in order to increase demand, but to intensify them.

Labour supply can be strengthened in many ways; for example, the report of the working group for the employment package includes descriptions of some concrete measures. Important issues include, for example, reducing the attractiveness of early retirement paths (known as the unemployment path to retirement), increasing the participation of young women in the labour market (family leave reform), alleviating the incentive traps related to income support and housing allowance, and enhancing the retraining of the unemployed and the process of guiding them back into the labour market. Labour taxes should be lowered but, for the above-mentioned reasons, only if reducing taxation can be compensated for with other measures.

The functionality of labour markets should also be promoted, for example, by increasing the housing supply in growth centres. Also, the possibilities for local wage bargaining should be increased in the labour market.

For general government finances, employment rate and competence, it is important to strive to bring university graduation forward.

### **3. Boosting know-how and restructuring capability**

In the last resort, economic growth is the growth of productivity. Increasing productivity is based on know-how, innovations and the ability to direct resources in the most profitable way at a given time. Finland's productivity growth has not only been low in recent years, but also in comparison to our most important competitor nations.

At the same time, the level of education has ceased to rise and Finland's ranking in this respect has sunk to the medium level of OECD countries. PISA results indicate that the basic abilities of young people have declined and the number of low achievers has grown. It is estimated that young people's skill levels in Finland are generally on the decline. This is a problem, because competence demands in the labour market continue to grow. That is why the differences related to educational levels in the labour market are increasing.

Despite some individual peaks, the level of scientific research is only a little above the OECD countries' average, although the university sector's public funding is still at a reasonable level, internationally speaking, regardless of the cuts made. The R&D investments of the corporate and public sector have fallen.

Although these changes are not the reason for the decreasing growth of productivity, strengthening the country's knowledge base and innovation activities is a prerequisite for increasing long-term productivity growth.

The innovation system could be supported by restoring the resources of Tekes, the Finnish Funding

Agency for Innovation, to where they were a few years ago. This could be financed by cutting other business subsidies over the course of several years (from 2019 onwards). There is every reason to continue simplifying the regulation of product markets and to increase the use of digitalisation and the market mechanism in the production of public services, founded on thorough preparation.

It is essential to stop the disintegration of the country's knowledge base and to reverse its decline. Finland should be made a considerably more attractive place for foreign experts than it is now, which requires a high-profile programme.

An even more important goal is to improve the educational and competence level of Finns. A larger proportion of the population than at present must have access to high-quality university education. This requires the development of the educational system's structure, modes of operation and also funding.

It would be wise to divide the university system into wide-ranging research universities of international level and universities focused on education. There cannot be very many of the former, but the number of the latter need not be restricted.

Bachelor degrees should be made more extensive than they are now. Bachelor and master's degrees must be separated in such a way that it is always necessary to apply separately for a master or doctoral programme after completing a bachelor degree (in other words, the Bologna process must be implemented thoroughly).

Enrolment in higher education and degree completion times must be accelerated; they are exceptionally long in Finland. There are valid grounds for utilising the matriculation examination to a higher degree in decisions on the admission of students. Alongside the development of educational guidance, students' advancement in their studies should be made more clearly the condition for receiving student financial aid and being granted the right to study.

Study places for bachelor programmes, especially, should be increased at least temporarily in order to reduce the accumulation of applicants. This and other structural reform measures require at least temporary public front end financing (i.e. recapitalisation). Over the long term, the front end financing for the expansion and qualitative development of university education must come mainly from private sources, which in practice means tuition fees. Moderate fees will not reduce the equality of opportunities if they involve a well-designed student loan system.

At earlier levels of education, the focus must lie on ensuring that everyone acquires sufficient basic skills. This requires an increased investment in identifying and alleviating the learning difficulties of children with problematic home lives, migrant backgrounds and, to some extent, often also boys. A valid option for reducing the number of young people who become marginalised and fall out of the educational system is to raise the compulsory school age to 18. The net costs resulting from this would not be great. Success in this requires developing suitable alternatives in upper secondary level education.