Finland: growing and reforming, but no time for complacency

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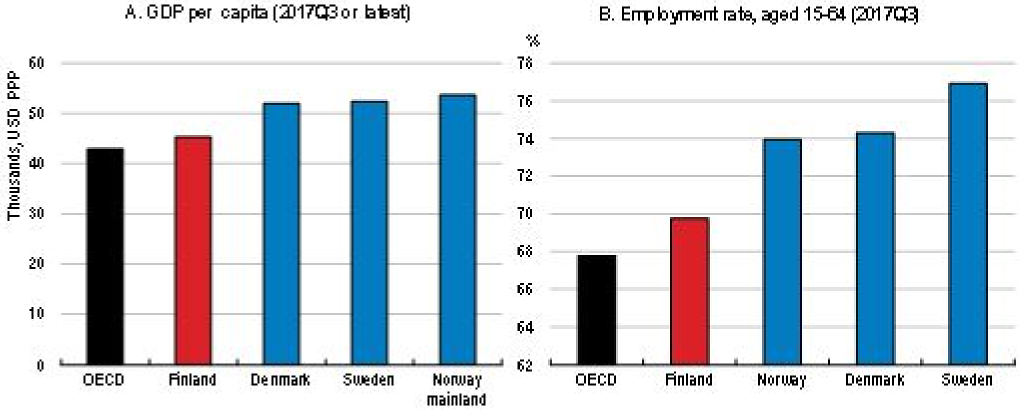
After a long period of lacklustre economic performance, robust growth has resumed. The Finnish economy suffered a series of sizeable adverse shocks alongside the global financial and economic crisis, facing major difficulties in the electronic and forest industries, in addition to a severe recession in Russia. Sound fundamentals and policy settings helped weather the impact of those shocks, and by early 2017 the economy had regained strong momentum. The recovery is broad-based across economic sectors, employment is picking up, and high business and consumer confidence point to a strong expansion going forward.

But challenges remain, as the 2018 OECD Economic Survey of Finland shows. GDP *per capita* exceeds the OECD average, but is significantly lower than in Denmark, Germany and Sweden, reflecting differences both in productivity and labour utilisation (Figure 1). A rapidly ageing population reduces labour supply and puts pressure on public finances. Hence, future growth and well-being will hinge on a higher employment rate and productivity gains, both in the private and public sectors. Reassuringly, these challenges are well understood by the government, which has been implementing structural reforms across a wider range and with more determination and coherence than in most other OECD countries.

Figure 1. GDP per capita and employment rate are below the other Nordics

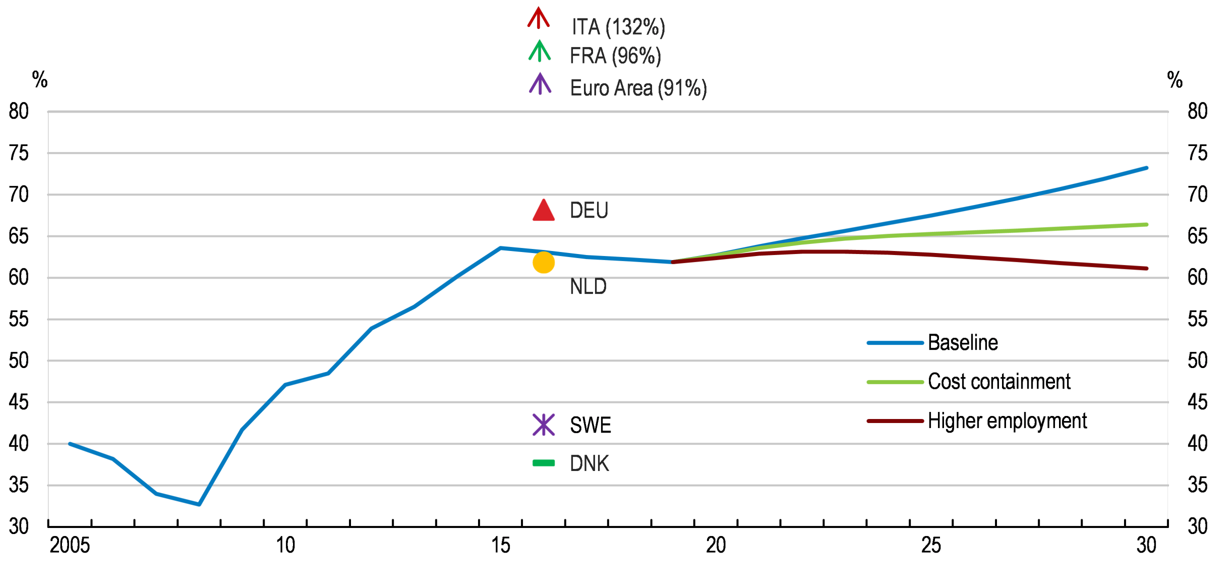


Source: OECD Economic Outlook database; and OECD Labour Force Statistics database.

Many of these reforms concern the labour market. The 2016 Competitiveness Pact between the government and the social partners lowers unit labour costs by about 4% from 2017 by internal devaluation. The social partners have also moved from a system of national-level collective agreements towards a system of “organised decentralisation”, where sector-level collective agreements are coordinated following the lead of export industries, and more leeway is given to local-level bargaining. Furthermore, the duration of unemployment benefits was reduced by 100 days in 2017, a job search requirement and a new activation model for the unemployed were introduced, the trial period for new hires was extended and education made more modular and nimble to better respond to evolving skill needs.

The health, social services and regional government reform will shift the responsibility for organising health care and social services from municipalities to 18 newly created autonomous counties from January 2020, bringing the sub-national government structure closer to that of the other Nordic countries. Goals of the reform include providing people with more equal services, increasing freedom of choice and improving the sustainability of general government finances. The reform is welcome, and its success is crucial to meet the needs of an ageing population and ensure long-term fiscal sustainability (Figure 2).

Figure 2. Health reform and higher employment would help stabilise debt[1]



1. Economic Outlook No.102 projections are used until 2019. Thereafter, in the ageing-related cost pressure scenario, increases in health and long term care spending are based on the cost pressure scenario in de la Maisonneuve and Oliveira Martins (2013), and increases in pension outlays are based on OECD (2017c). The cost containment scenario assumes that reforms to the provision of health care and social services reduce growth in related spending by half. The higher employment scenario assumes cost containment in age-related spending and a higher employment rate of the population aged 15-64, which rises to 74% in 2030.
Source: OECD Economic Outlook database and OECD calculations.

The strong pick-up in economic growth and an impressive reform record are reasons for optimism, not complacency. Social welfare reform could boost employment further, as many unemployed today will see only small net income increases or even incur a loss upon return to work. Coordinating the tapering of various working-age benefits against earnings could drastically improve work incentives and transparency, while preserving the current level of social protection, and is hence a more promising route for future reform than a basic income. Furthermore, specific measures could lift work incentives for parents and older workers. Combined with the new income registry linking benefit payments to real-time incomes from 2019, such reforms would make for a truly efficient and inclusive benefit system, adapted to evolving work patterns. Work incentives could be further strengthened by reducing the tax burden on labour while further increasing indirect and property taxes and reducing tax expenditures. Such a tax shift, along with measures to support business development and entrepreneurship could also give productivity a welcome boost.

References

OECD (2018), *OECD Economic Surveys: Finland 2018*, OECD Publishing, Paris. http://dx.doi.org/10.1787/eco_surveys-fin-2018-en