

Finland: growing and reforming, but no time for complacency

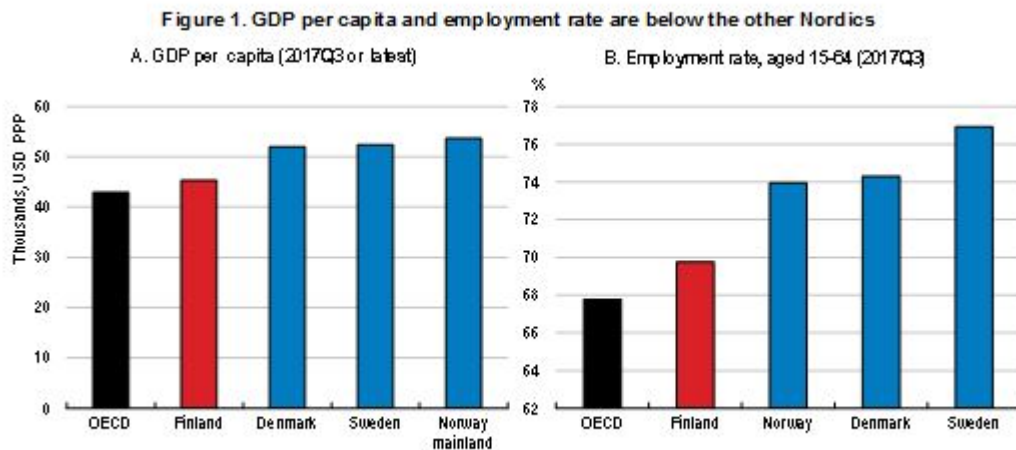
Category: Finland,Uncategorized

written by oecdecoscope | March 1, 2018

By Christophe André and Jon Kristian Pareliussen, OECD Economics Department

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.

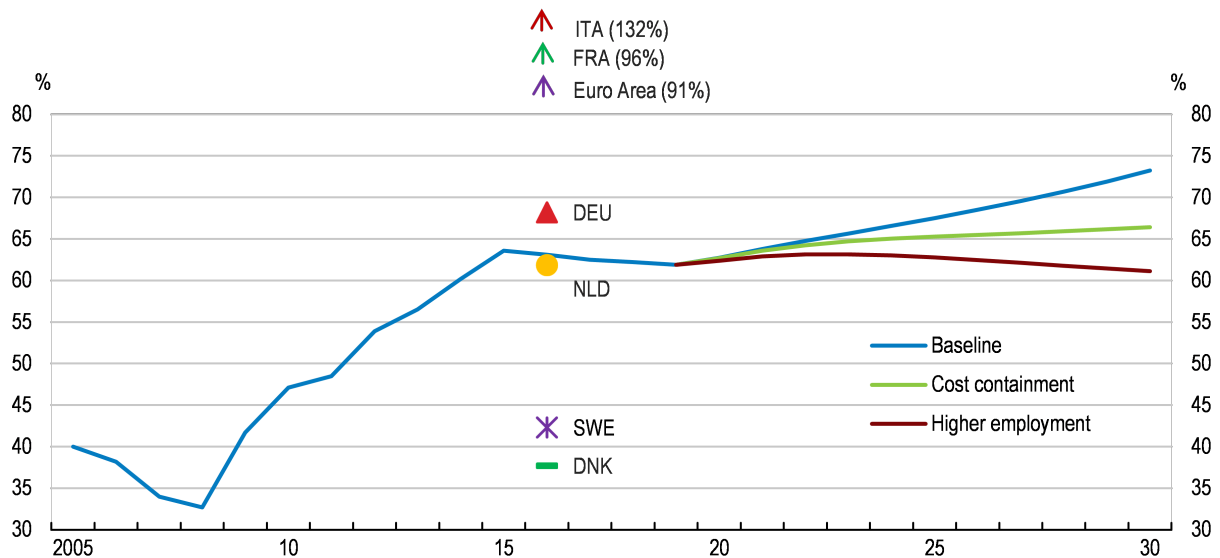


Source: OECD Economic Outlook database; and OECD Labour Force Statistics database.

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 debt¹



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

Structural reforms in a difficult time

Category: Labour markets, Structural reform, Uncategorized
written by oecdecoscope | March 1, 2018

By Naomitsu Yashiro,

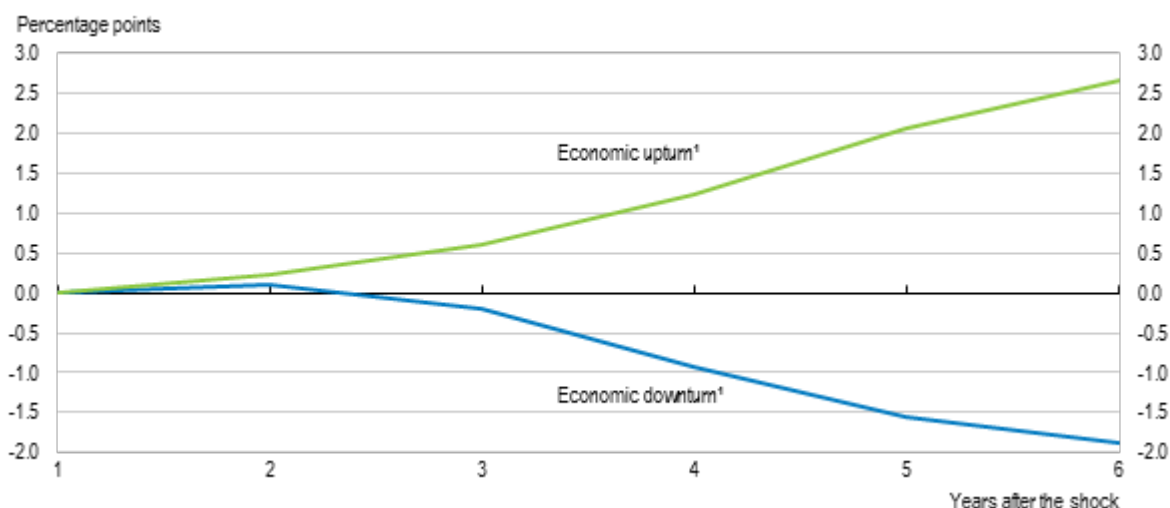
Structural Surveillance Division, OECD Economics Department

The pace of structural reforms is slowing just when the world economy needs decisive policy actions to strengthen fundamentals and restore healthy growth (the 2016 *Going for Growth* report). Policy makers may be concerned that introducing structural reforms in the current context involve trade-offs between the mid- to long-run gains in employment and productivity and short-run losses.

In our recent paper (Caldera Sánchez, de Serres and Yashiro, 2016), we note that when the economy is near its potential, and confidence among consumers and investors is high, gains from growth-enhancing reforms have been found to exceed potential losses even in the short run, as demand increases on the anticipation of the future benefits. However, the short-term impact of reforms may be less favourable when they are introduced in difficult macroeconomic conditions, as several factors may prevent a pick-up in demand. In some circumstances, specific reforms may even entail short-term reductions in demand.

There are several conflicting channels through which reforms affect the real economy. The strength of the channel can change under different macroeconomic conditions. Take reforms of unemployment benefits that aim to improve work incentives by strengthening the conditionality of income support in the case of a lay-off on intensive job-search efforts. By facilitating the return to work, such reforms raise employment, household income and thus consumption. However, uncertainty regarding disposable income also increases, potentially discouraging consumption. In good times, employment gains can be quick, so that output increases within 2-3 years after reforms. But during recessions when the unemployed are less likely to find jobs the gains in employment can even turn negative (See figure).

The gains in employment of an unemployment benefit reform can turn negative during a downturn



Note: The lower (upper) line corresponds to the impact of the reduction in the initial unemployment benefit replacement rate during economic downturn (upturn), where the economic cycle is measured through the level of the pre-reform unemployment gap (i.e. the difference between the structural unemployment rate and the unemployment rate). The economic downturn (upturn) corresponds to the case where unemployment gap is set to the

minimum (maximum) value within the sample.

Source: Bouis et al. (2012).

Other reforms that seek to restore competitiveness through lower relative costs and prices can also depress demand if conducted during downturns. This is because in bad times labour and goods demand respond little to the lower wages and product prices resulting from reforms, while workers or firms see their income and profit eroded in the short term. Ideally, governments can deploy expansionary fiscal policies or monetary policies to support demand. But, in some cases, macro policies may also be constrained, as has been the case for several countries in the past few years. Strong external demand can help to bring forward the benefits of reforms as well. For instance, our review of case studies suggests that Canada's labour market reforms around the mid-1990s benefited from strong demand from the United States. This supported the gains in employment following the reforms.

Even under limited supports from fiscal and monetary policies or external demand, a smart packaging or sequencing of reforms can alleviate the negative short-run impacts on demand: (1) reforms of labour and product markets can be conducted in tandem, so that the lower prices from stronger competition limit the impact of labour market reforms on real wages; (2) addressing dysfunctions in the financial sector as early as possible can improve access to credit and allow households and firms to capitalise on the future benefits of reforms and expand consumption and investment today; (3) reducing policy uncertainty through well-communicated, credible reform strategies can prevent the deterioration of confidence among business and consumers.

Many reforms can boost demand by themselves even during difficult macroeconomic conditions. For instance, measures aimed at raising investment in knowledge-based capital, including through infrastructure spending, as well as tax

structure reforms can bring short benefits. Also, reducing regulatory barriers to entry in services sectors with large pent-up demand and relatively low entry costs (like professional services or taxis) can boost business expansion and employment relatively quickly. Similarly, reducing barriers to geographic or jobs mobility can increase the speed of employment gains in difficult times. Strengthening active labour market policies and to alleviate skill shortages and mismatch can unleash business activities that were previously constrained by skills bottlenecks. Reforms that contribute to the long-term sustainability of public finance and to the cost-effectiveness of healthcare or pension systems can reduce uncertainties on household's future income, thereby boosting consumption today.

References:

Caldera Sánchez, A., A. de Serres and N. Yashiro (2016), "Reforming in a difficult macroeconomic context: A review of the issues and recent literature", OECD Economics Department Working Papers, No. 1297, OECD Publishing, Paris.

OECD. (2016), Economic Policy Reforms 2016: Going for Growth Interim Report, OECD Publishing, Paris.