FORECAST

Raising the employment rate to 75% will require much faster economic growth

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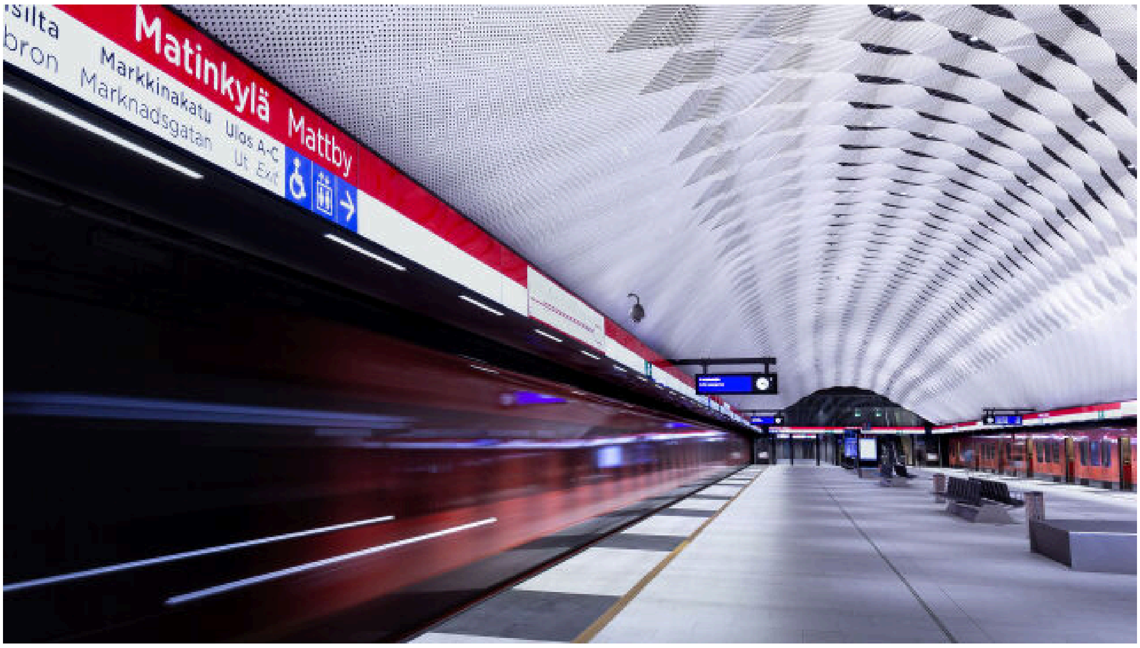
One of the key goals of the Government Programme is to raise the employment rate to 75% by the end of the government term. This means increasing the current number of people in employment by around 75,000 by the end of 2023. Raising the employment rate to 75% is a prerequisite for balancing general government finances and reducing the sustainability gap in the public finances, as set out in the Government Programme.

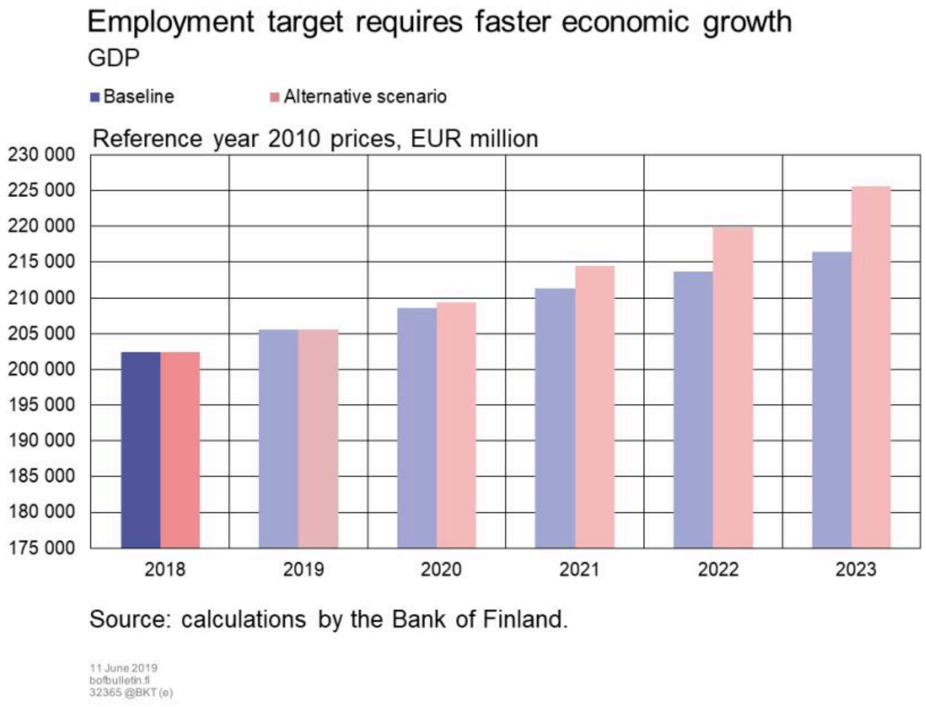


If near-term economic growth is to remain somewhere below 1.5%, i.e. as foreseen in the baseline forecast, achievement of the objective will be unlikely. Between 2020 and 2023, GDP growth should be around 2.5% per annum, i.e. one percentage point faster than the baseline forecast, in order to achieve the target. Reaching the employment rate target would mean that between 2019 and 2023, employment would need to be increased by around 75 000 persons.

This alternative scenario does not aim to assess which measures are needed in order to raise the employment rate. Notwithstanding, the alternative scenario does assume that productivity growth will accelerate, competition on the commodity markets will increase and labour market performance will improve. It is clear that in order for these assumptions to materialise, structural reforms are required, including structural reforms on the labour market. However, the scenario does not express an opinion on the nature of these reforms and subsequently does not, for example, include the actions set out in the Government Programme. As the risks to Finland's international economic environment are currently on the downside, the alternative scenario assumes that the export markets will not grow faster than the baseline, but that demand will be more focused on Finnish export products. The scenario was produced using the Bank of Finland's general equilibrium model.[1]

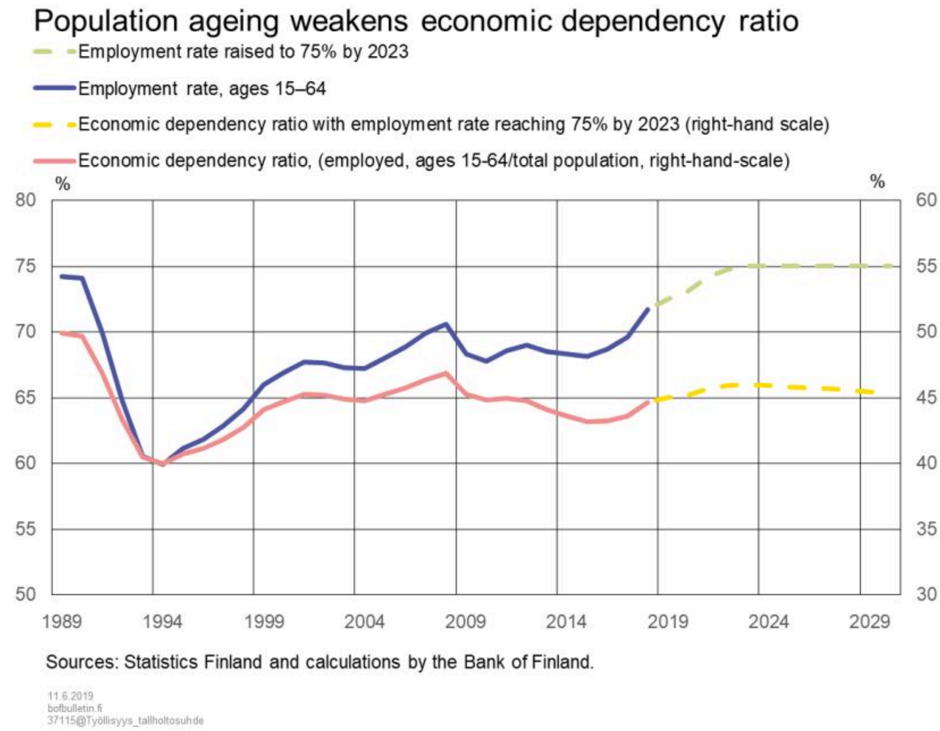
The employment rate has markedly increased in recent years. Its trend was 72.4% in the first quarter of 2019, which is significantly higher than the peak before the financial crisis. The pick-up in economic growth, the upswing that has lasted for several years, as well as structural reforms on the labour market have increased the recruitment of new employees (Chart 1). Recent measures that have influenced the structure of the labour market include changes made to unemployment benefits that have strengthened the incentives to work. Demand for labour, in turn, has been supported by the Competitiveness Pact, which resulted in a reduction in labour costs.

Chart 1.



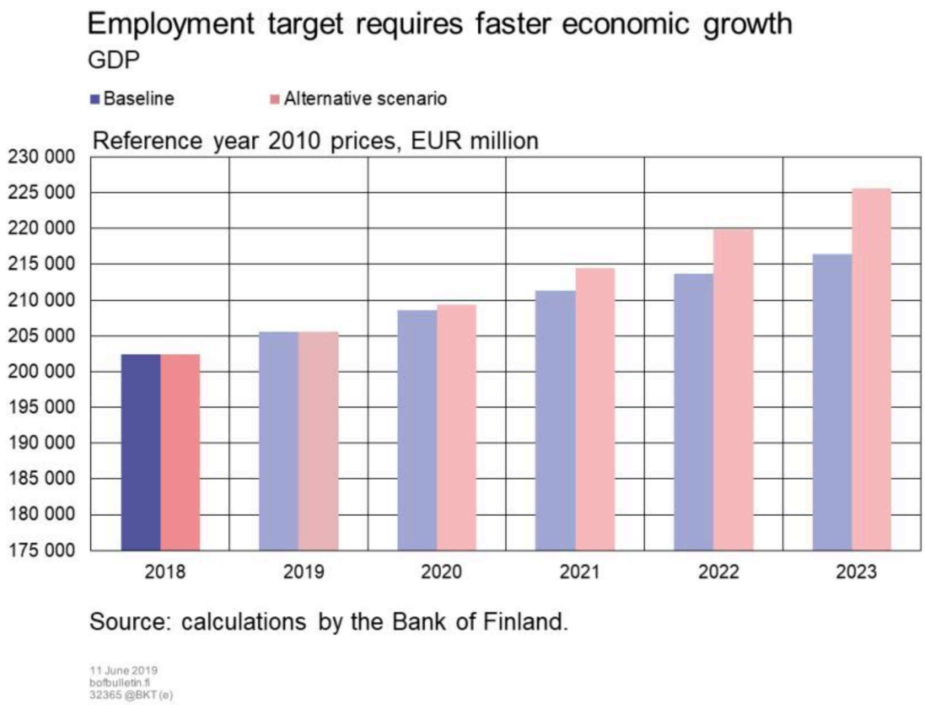
Based on the estimate, between 2020 and 2023, GDP growth would have to average around 2.5% per annum, i.e. one percentage point faster than in the baseline forecast, in order to achieve the employment rate target. Raising the employment rate to 75% would require that in 2023, GDP would exceed the baseline by almost EUR 9 billion (Chart 2). Significantly faster economic growth, in turn, requires significantly improved productivity and stronger investment and export growth.

Chart 2.



Structural factors behind economic growth, such as productivity growth and labour market mechanics, have a key impact on employment development. Technically, in the model estimate, productivity is expected to improve markedly faster than in the baseline forecast, which will also increase labour input over time. In the baseline forecast, productivity growth is estimated to be around 1% per annum, which is close to the historical average since the introduction of the euro. However, in the alternative scenario, productivity is estimated to grow faster than the long-term average, with an average annual growth rate of 1.5%. Growth is most affected by accelerating productivity growth and improved performance of the domestic market, whereby competition in commodity markets increases and labour market performance improves (Chart 3).

Chart 3.



The scenario assumes that from 2020 to 2023, the number of working hours grows almost parallel to the employment of 15–64-year-olds. Wages will remain on the same growth path as the baseline forecast despite markedly improved productivity growth, as labour market performance is expected to improve. Productivity growth increases domestic output and strengthens cost-competitiveness. Output growth, in turn, increases the number of working hours and persons employed. This boosts real purchasing power, as increased working hours raise the wage bill and improved productivity slows price increases.

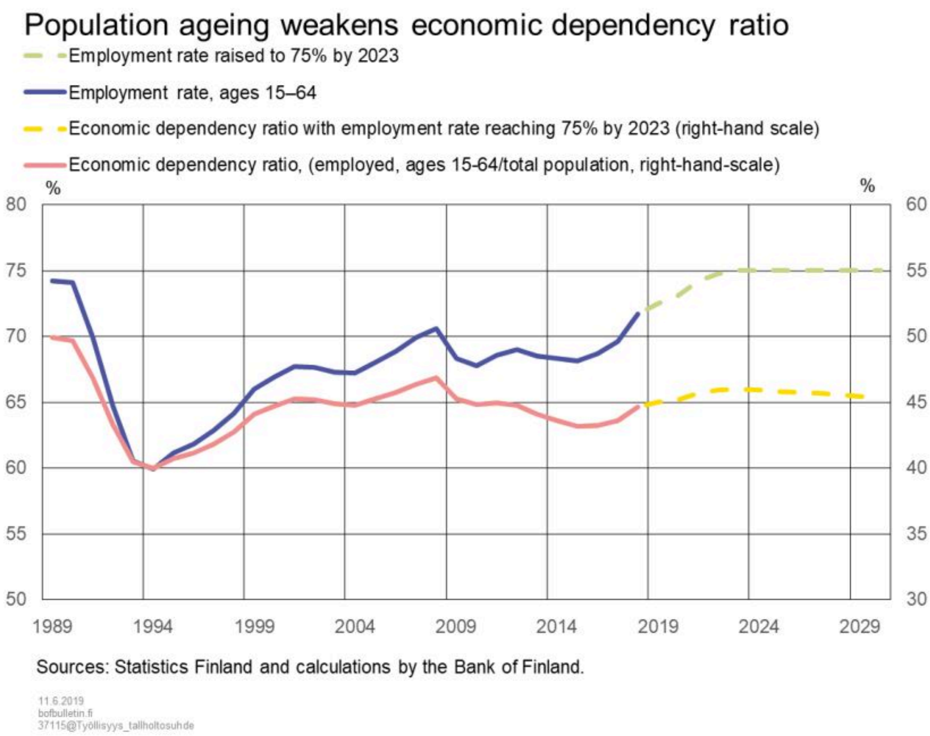
In order to increase productivity and employment, both non-residential investment and exports must be raised significantly from their current levels. In the alternative scenario, investment and export growth will pick up markedly despite the assumption that export demand is similar to the baseline forecast. This is partly due to a marked improvement in cost-competitiveness. On the other hand, the scenario also assumes that demand will be more focused on Finnish export products than currently. Although the basic conditions in the Finnish economy for accelerating investment and export growth exist—for example, good profitability of companies, low financing costs and strengthened cost-competitiveness—the realisation of growth and exports clearly outpacing the baseline forecast also requires the dissipation of uncertainty in the global economy in order to increase the market shares of exports in a manner consistent with this scenario.

The rise of unit labour costs slows down. Higher domestic demand and growing exports also increase imports. Against a backdrop of improved price-competitiveness, net exports strengthen compared with the baseline. Investment growth is affected by enhanced productivity, which helps improve expected returns on investment. Investment picks up, boosted by exports and domestic demand. Accelerated economic activity improves the employment situation and decreases unemployment. The amelioration of the employment situation and growth of the wage bill increase households' purchasing power and private consumption.

Overall, due to higher productivity growth, the improved performance of the domestic market and the stronger competitiveness of the export sector, the alternative scenario foresees the economy adjusting to a faster growth path. The alternative scenario does not evaluate the impacts of faster economic growth on the public finances. However, significantly increased employment and, similarly, reduced unemployment would increase the imputed tax revenue for the public finances and reduce unemployment expenditure, thereby strengthening Finland's general government balance. Then again, their impact on the public finances will depend on, for example, whether strengthening the incentives to work, increasing labour policy or alleviating labour market mismatch problems would actually improve labour market performance.

Raising the employment rate to 75% during the government term would strengthen the sustainability and funding base of the public finances, as it would also increase the ratio of employed persons to the total population, i.e. the economic dependency ratio. As the population ages, the proportion of the population of working age relative to the population as a whole continues to shrink, which is why higher employment does not improve the dependency ratio to a corresponding degree. With the current population projection, the 2023 target employment rate of 75% would raise the proportion of the employed population to 46%. Thus, the dependency ratio would remain lower than before the financial crisis, even though the employment rate would be close to 5 percentage points higher (Chart 4). Correspondingly, even though the employment rate would remain at 75% after 2023, the economic dependency ratio would yet again begin to deteriorate, as the proportion of the population of working age would further decline.

Chart 4.



The 75% employment rate target set in the Government Programme is an important target. By international standards, it would be among the highest in the OECD countries. For example, in Norway, Denmark, Sweden and Germany, the employment rate is 75% or higher. Economic structures and external demand will ultimately determine whether Finland can achieve the employment rate target.

The alternative scenario assumes that employment will rise mainly due to supply factors, but demand factors are also taken into account. Productivity and non-residential investment as well as export growth can be influenced only indirectly, for example by investing in education and research. However, the productivity impacts of such investments take time to unfold. In the current global economic situation, where there is considerable uncertainty associated with the development of export markets, a 75% employment rate is a challenging objective.

Table 1.

Alternative scenario: Achieving a 75% employment rate

		2019	2020	2

% change on previous year, unless otherwise specified			
GDP	Baseline forecast	1.6	1.5
	Alternative scenario	1.6	1.8
	Difference	0.0	0.3
Imports	Baseline forecast	1.9	1.8
	Alternative scenario	1.9	2.0
	Difference	0.0	0.2
Exports	Baseline forecast	2.8	2.1
	Alternative scenario	2.8	2.5
	Difference	0.0	0.4
Private consumption	Baseline forecast	1.3	1.4
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	Difference	0.0	0.1
Private investment	Baseline forecast	2.2	2.0
	Alternative scenario	2.2	3.1
	Difference	0.0	1.1

Employed, change, 1,000 persons	Baseline forecast	22.7	8.0	9
	Alternative scenario	22.7	14.2	3
	Difference	0.0	6.2	2
Unemployment rate, %	Baseline forecast	6.5	6.4	6
	Alternative scenario	6.5	6.2	5
	Difference	0.0	-0.1	-
Employment rate, aged 15–64, %	Baseline forecast	72.5	72.9	7
	Alternative scenario	72.5	73.1	7
	Difference	0.0	0.2	0

Footnotes

1. Kilponen – Ripatti – Orjasniemi – Verona, 16/2016. ↑

Key words

alternative scenario, employment rate, employment target, Government programme