Editorial

Editorial: Ambitious objectives needed for structural reforms and cost-competitiveness

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The depth of the problems facing the Finnish economy is widely understood. It is now time to set ambitious objectives and proceed to solutions.



The Bank of Finland has emphasised that the problems of the Finnish economy are not primarily cyclical, but largely of a longer-term, structural nature. In addition to the weakness of the global economy, activity has been dampened by structural changes in Finnish industry, a contraction in the working-age population, weakening cost-competitiveness and, recently, also the difficulties in the Russian economy. As general government deficits have grown and a rapid increase in the population share of elderly people is looming, the longer-term outlook for the public finances has deteriorated. The Bank of Finland has pointed out that the key to resolving the serious problems in the economy lies in structural reforms, fiscal consolidation and improved cost-competitiveness.

The Bank of Finland's regular assessments of domestic economic performance and economic policy are based on the objectives set for the Eurosystem and the Bank of Finland itself. Of these, the primary objective is price stability. Domestic economic policy themes that are important for ensuring the conditions for price stability include the state and, in particular, long-term sustainability of the public finances. For this reason, the Bank of Finland regularly evaluates the scale of necessary fiscal consolidation and structural reforms. The Bank of Finland also presents its assessments of domestic cost developments. Improving the conditions for balanced economic growth supports fiscal sustainability.

The choice of individual fiscal policy measures or structural reforms often encompasses value judgements that the central bank is not mandated to make. The Bank of Finland presents its assessments of how different structural reforms will affect general government sustainability and what effects fiscal policy measures will have on the public finances. It may also recommend the implementation of such individual structural reforms in the absence of which the attainment of general government sustainability appears unlikely. These include pension reform. The Bank of Finland's evaluations are based on research, international experiences or otherwise publicly justified analysis.

In the current situation, continued fiscal consolidation cannot be avoided. Structural reforms are needed, but their effects on the public finances will take several years to materialise in full, and assessments of the size of their impact are always surrounded by uncertainty. The scale of the consolidation measures envisaged by the Government is justified. The objective of bringing the general government debt ratio onto a downward trajectory is a key priority.

Consolidation measures that would turn the debt ratio onto a downward trend in the immediate years ahead would not yet guarantee long-term fiscal sustainability. Population ageing will already weigh more heavily on the general government financial balance at the turn of the next decade. The pension reform to be submitted to Parliament for decision will improve the outlook, but fiscal sustainability and the conditions for economic growth will additionally need to be bolstered by other significant structural reforms.

The objectives of the spring 2014 structural policy programme were adequate in scale, but the reforms were not implemented in the manner required for the attainment of the objectives. The new Government's programme incorporates aspirations and policy outlines for important reforms. They focus, in particular, on a social and health care reform aimed at achieving cost savings, and improved conditions for housing supply. Now is the time to make decisions on important structural reforms and to implement them.

In addition to the measures listed in the new Government's programme, major effects could be

expected from reforms that would improve the conditions for housing supply more ambitiously than envisaged, would reduce regulation that hinders competition and would increase the supply of labour. Research literature suggests such reforms would keep price and cost increases in check and improve productivity and employment.

For overcoming the problems in the economy, one crucially important objective is the containment of domestic cost developments. According to different indicators and estimates, the need to improve cost-competitiveness in Finland is currently 10% or more, as measured in terms of the evolution of unit labour costs in the economy as a whole relative to the average of our trading partners. Consequently, the proposals for improving cost competitiveness that have been up for discussion in recent weeks are warranted.

The pay settlement agreed in autumn 2013 ended the weakening trend in cost-competitiveness but did not yet lead to essential improvements. This is due to the fact that wage increases are, on average, also muted in our trading partners. Likewise, in the coming years, moderate pay settlements will have an important role to play in this respect, but on their own they will improve cost-competitiveness only very slowly. Hence, other measures will also be needed.

Although euro area price developments have been too subdued relative to the price stability objective, cost containment in Finland is vital. The deflationary threat in the euro area will be combated by single monetary policy tools, rather than raising an individual member state's cost and price level. If costs and prices in Finland continue to rise relative to the euro area average, Finland will later face a more difficult task of cost adjustment – irrespective of how euro area prices develop on average.

The Finnish economy is facing headwinds. The severity of the problems is widely understood. It is now important to stay committed to ambitious objectives and proceed to implementation.

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