Editorial

The worst-case scenario in the corona spring did not materialise, but we will still need stamina for the long haul

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The corona pandemic serves as a reminder that healthy public finances provide an irreplaceable shield when we hit hard times. It is now important to both time and target the fiscal policy stimulus effectively and take forward structural reforms. Finland's labour market, too, has a vital role to play as the economy enters the recovery phase.



The economic impact of the coronavirus pandemic is now entering a new phase. During the spring, output contracted sharply as lockdown measures were imposed, limiting movement, gatherings and business activity in order to contain the spread of infection. These restrictions have now been relaxed in many countries, allowing economic output to begin to expand once again.

But there is no certainty that output and employment will suddenly take off again. Households and

businesses are exhibiting caution in their consumption and investments. The financial position of many is weaker than before. There also remains a risk of the epidemic flaring up again, in Finland and elsewhere around the world.

In Finland, the brunt of the crisis fell on the service sectors, whose prospects are now being improved with the easing of the lockdown. But the export sectors are subject to a different rhythm: in particular, the sluggishness of global investment demand is keeping the order books of many industries empty. The outlook is bleak for the export sector in the second half of 2020 and through 2021. Adding to the uncertainty is the risk to the banks of increased loan losses.

When the lockdown was in force, the role of economic policy was to build a bridge and assist households and businesses through the worst of the crisis. It was vital to prevent a wave of bankruptcies and the emergence of mass unemployment. A measure of continued support for households and businesses is still needed as long as output remains low in parts of the economy.

Now the lockdown has begun to be relaxed, a fiscal policy stimulus to support aggregate demand has become more important. Such a stimulus is useful when the main factor limiting output is exceptionally weak aggregate demand. Where necessary, even a substantial stimulus may be considered in those countries where the public finances are sufficiently strong and the long-term growth outlook is sufficiently positive.

In the advanced economies, general developments in the economy have derived significant support from the monetary policies pursued by their central banks in addition to the decisions of banking supervisors and the macroprudential authorities. By protecting the liquidity of the financial markets and securing the lending capacity of banks, these measures have safeguarded funding for businesses and households.

Coordinated measures have also been agreed at the EU level. These will address issues especially in those countries, regions and industries that have been worst affected by the pandemic and its economic impact.

The general government finances of some EU countries have become so weakened by the crisis that their ability to support output and employment risks becoming entirely compromised, simply fuelling long-term challenges to the public finances.

The Commission's recent proposal for an EU recovery instrument is in broad outline a step in the right direction, even though it will undoubtedly be somewhat changed after processing by Member States. What is needed is a one-off, temporary and carefully targeted support package that is quickly available. From a Finnish perspective it is of paramount importance that the economy of our most important export customers, i.e. the European Union, is on a stable

foundation.

Looking forward, the sustainability of economic growth in Europe must be strengthened and competitiveness improved. Achievement of climate goals and acceleration of the digital economy cannot succeed without substantial investments and reforms. Stressing conditionality, this needs to be taken into account in regard to the kind of projects resources are directed into in the common European crisis measures now being planned.

With large amounts of public funds now being deployed to support national economies, there is reason to seriously consider the long-term outlook for general government finances in the EU countries, and here in Finland. It is necessary to focus – without pointless delays – on investments that will improve the future opportunities for growth and employment as well as on structural reforms in the economy.

The coronavirus pandemic serves as a new reminder that healthy public finances are an irreplaceable protection when we hit difficult times. It is now important that economic support measures are designed such that the fiscal stimulus is both timed and targeted effectively. The corona crisis should not be used to introduce permanent increases in public expenditure that will further exacerbate an already substantial sustainability gap. As normality returns, it will be more important than ever to build up our general government buffers, remembering the traditional wisdom that it is during the good times that we must prepare for the bad.

Deep economic crises often cast a lasting shadow over the economy, especially in regard to employment. A sharp rise in unemployment often means that a share of those suffering job losses will be left outside of working life for a long time, or even permanently. It can also mean that new, young graduates will be unable to find work on the labour market. This has been the experience with many previous crises. To avoid these developments, not only must the stimulus be successfully deployed during the acute phase of the crisis, but the incentives for employment must also be in place during the recovery phase. Because a deep crisis often results in permanent changes in the production structure of the economy, education and innovation policies, in particular, must be focused on the needs of the future.

In Finland, the general educational level of the population was on the rise for several decades, but this trend has been reversed during the past 10–15 years. Among young adult cohorts the level of educational attainment has turned downwards, which is exceptional in international comparison and concerning from a Finnish perspective. This trend can scarcely be considered positive, particularly when modern growth theory stresses the significance of education as a key factor in the accumulation of intangible human capital and the basis of a competent workforce, and as research data does not suggest any weakening in the returns to education. Therefore an increase

in university admissions – particularly in the current weak situation in youth employment – would seem to be well-founded also from the perspective of long-term productivity development in the economy.

As soon as national economies begin to recover, Finland must ensure that our companies are able to expand their output. The key here is the functioning of the labour market. In the early stages of the crisis, the social partners embraced responsibility in an important way by supporting expedient furlough schemes. A large number of bankruptcies and many redundancies were likely avoided as a result.

Economic forecasts now suggest that the Finnish labour market will have to show its mettle in the recovery phase, too. The price of labour in Finland's main advanced trading partners is expected to decline relative to Finland in the current year and in 2021. In many countries the price of labour responds rapidly to a weakening in the condition of the economy, unlike in Finland. For a small, open economy like Finland, this could result in the loss of jobs or a failure to generate new ones.

If these forecasts hold true, the prospects for a fall in the heightened level of unemployment and growth in the employment rate in Finland will weaken. During the crisis, Finnish companies have largely opted to reduce their workforce by furloughing workers. As the lockdown is lifted and demand picks up, it is important that businesses are once again able to offer a growing number of jobs. This will prevent temporary lay-offs from turning into widespread redundancies. These positive developments would be supported if we can prevent a renewed decline in cost-competitiveness.

Should labour costs in Finland rise faster than in other countries and not be accompanied by a proportionate rise in productivity growth, a share of export production that would have otherwise remained profitable could be abandoned in Finland. This would weaken the prospects for employment in industries in direct competition with foreign production. It would also weaken the generation of income in Finland, as well as weakening domestic demand and the desired recovery of employment in the non-tradable sector.

Economic forecasts are currently subject to a large degree of uncertainty due to the pandemic’s unpredictable trajectory. This uncertainty also extends to forecasts of labour costs in different countries. We should closely scrutinise how these forecasts eventually unfold and assess how the system of collective agreements can be harnessed to secure the competitiveness of Finnish labour and output, to preserve employment.

The first months of the coronavirus crisis are now behind us, with economic policy having to respond rapidly to unprecedented circumstances. What hopefully lies ahead is a phase where lockdown measures may continue to be lifted in different countries and where output will turn

from contraction to expansion.

Economy policy has responded to the crisis on many fronts, and with a force that has ensured the worst has – at least so far – been avoided. Finland has not experienced a sizeable wave of bankruptcies. Furlough schemes have meant that redundancies have remained fewer in number than initially feared.

The future nevertheless remains uncertain, and a number of important decisions on economy policy have yet to be taken.

For growth and employment to regain strength, economic policy must prove successful in responding to the immediate need for stimulus and to the increased need to support the long-term economic outlook. In Finland, key are reforms that can facilitate entrepreneurship, increase the available expertise and improve the functioning of the labour market. This will enable us to keep a grip on the rapidly growing level of public debt. Thus, the employment rate and productivity development will soon return to the economic policy agenda.

Although the worst did not materialise, we will still need stamina for the long haul, in regard to both public health and the economy.

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Keywords

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