Finland's experience with persistently slow economic growth

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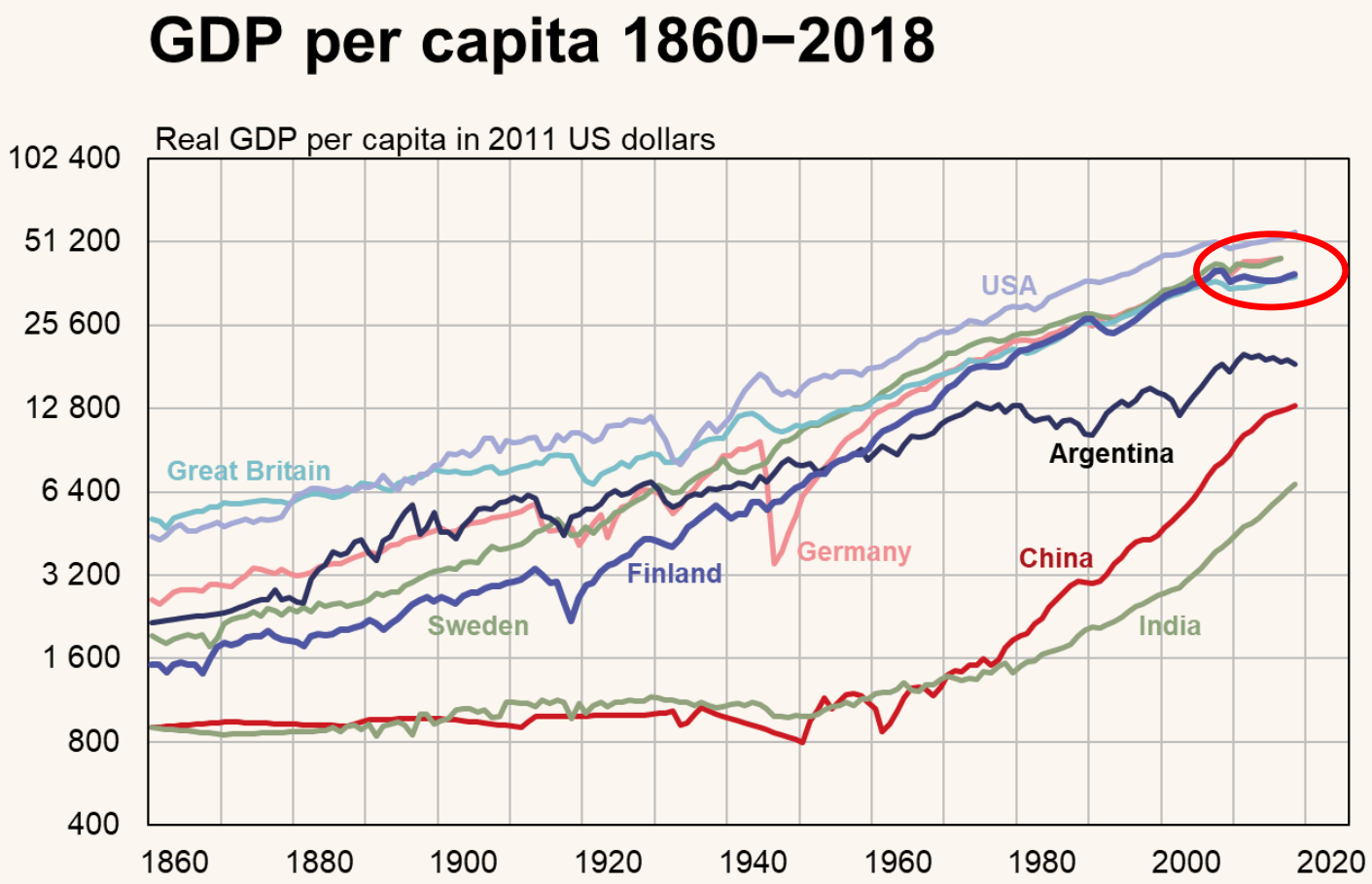
Living standards have not increased in Finland after the global financial crisis



Converted from national currencies by using purchasing power parities estimated with the so-called extrapolation method.
Source: Maddison Project Database 2020. Missing data points imputed by linear interpolation by the Bank of Finland.
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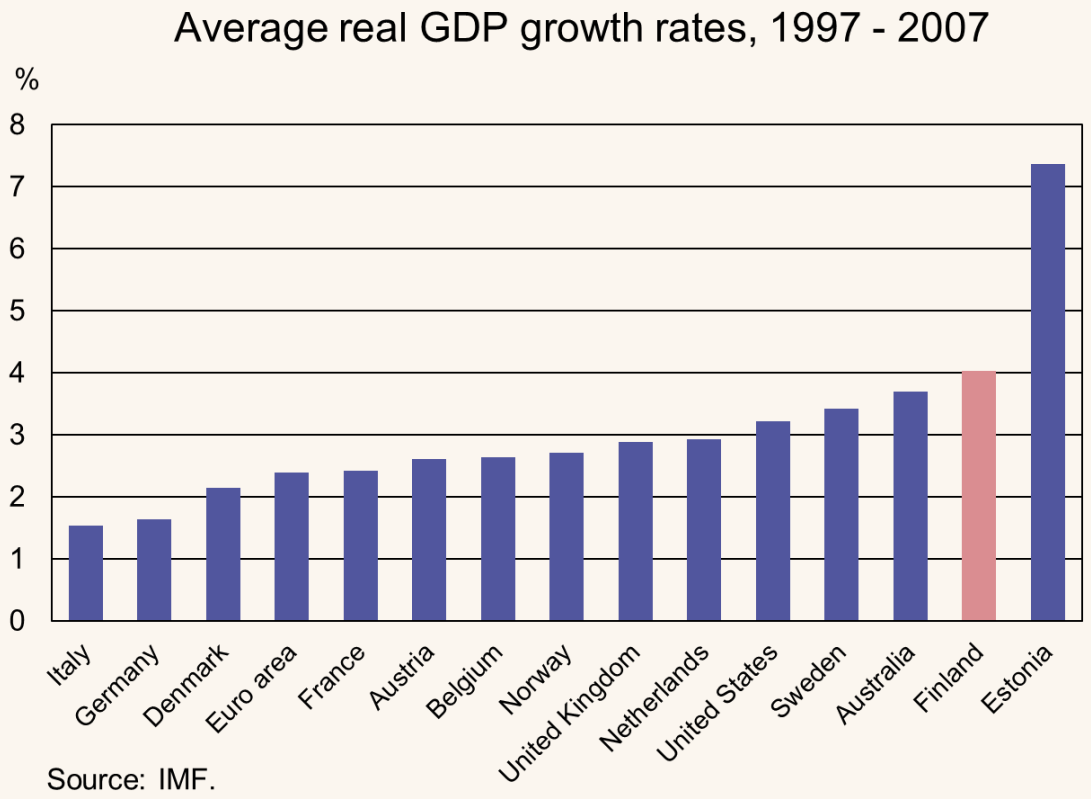
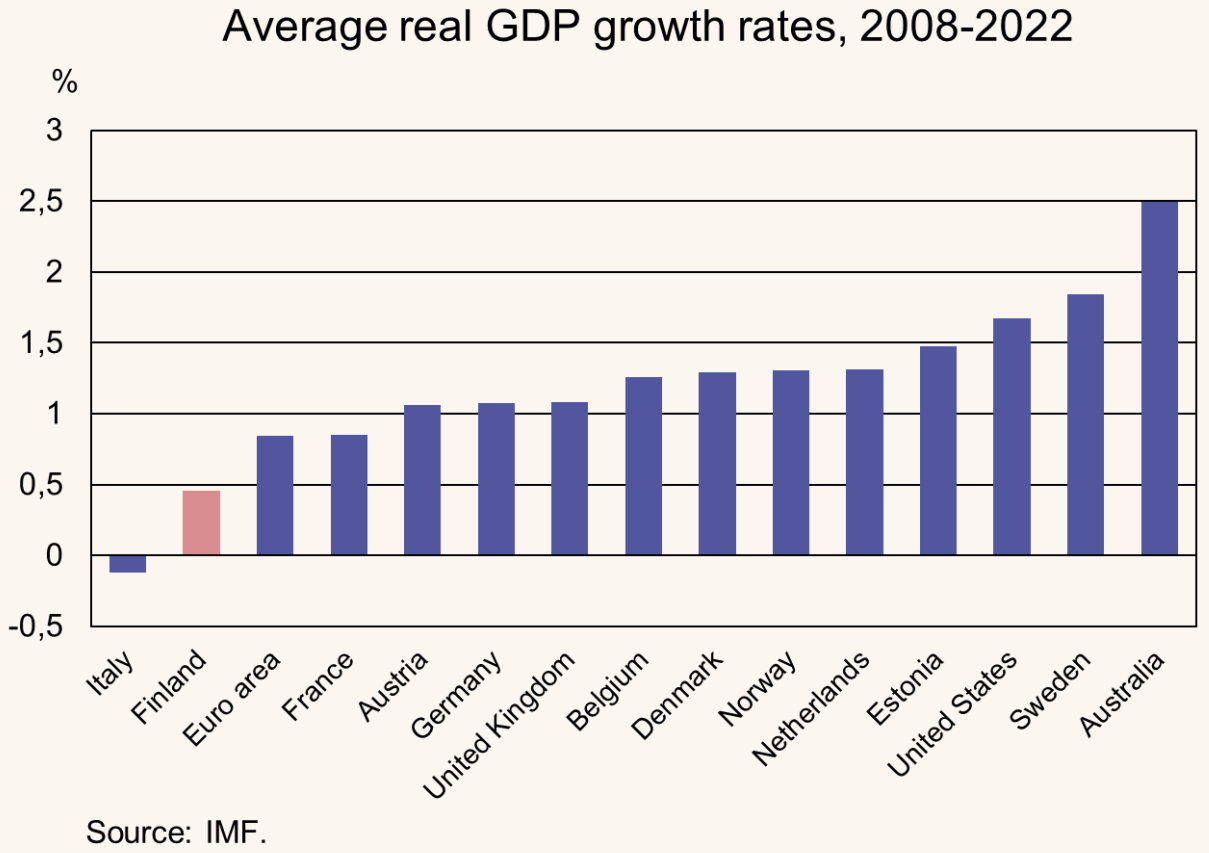
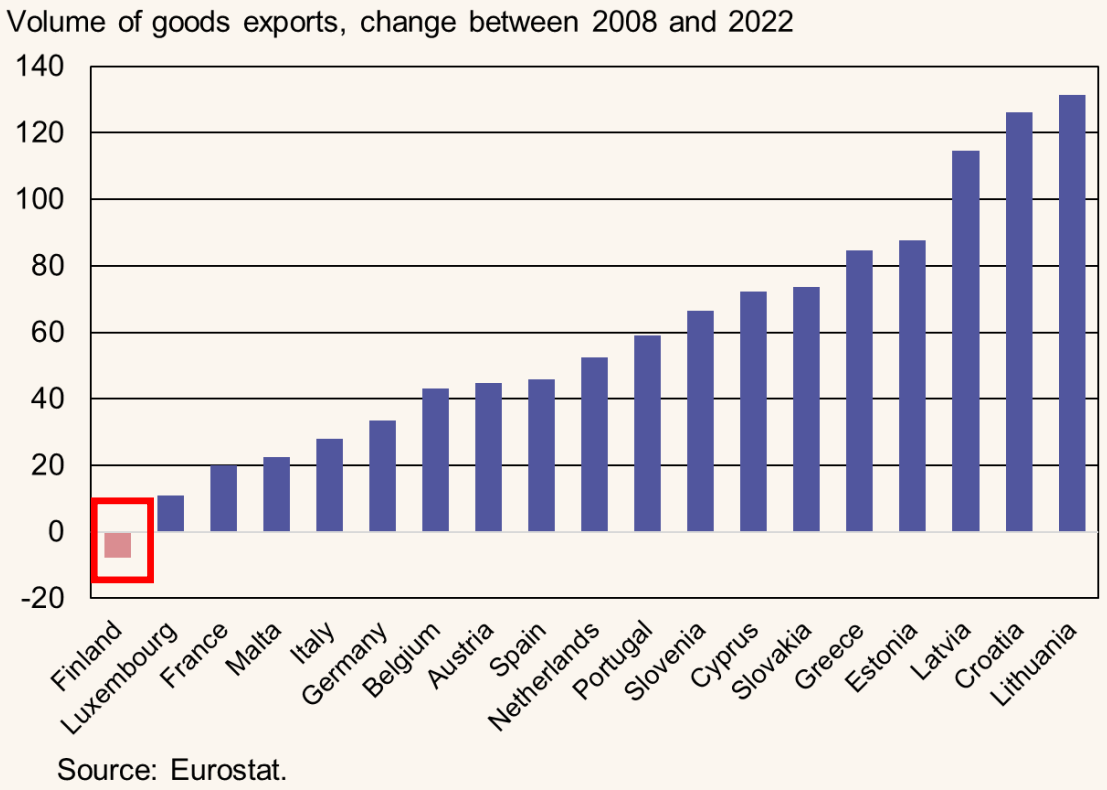
From top-performing advanced economy to growth laggard

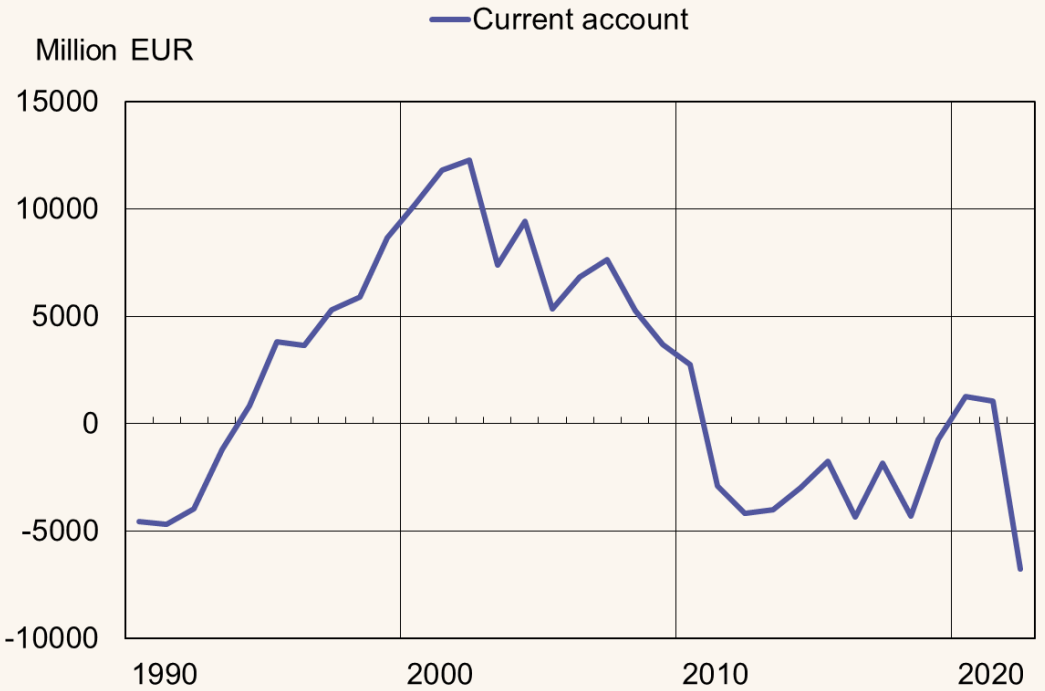




Finland's export performance particularly weak - Current account from large surplus to persistent deficit



Source: Eurostat.



Source: Statistics Finland.

Factors behind exceptionally good performance before 2008

- Investment in human capital / education system
  - Universities' focus in engineering starting in 1960s/1970s

- Recovery from exceptionally deep depression in the 1990s
  - Export-led growth strategy
  - Continued investment in R&D and education
  - Strong depreciation of the Finnish Markka
  - Cuts in labour costs and corporate taxes
  - Structural change – reallocation of resources – creative destruction

- Growth of ICT sector
  - Framework conditions in place

- EU accession
  - Fiscal discipline / consolidation / financial conditions

Period of low growth – what happened?

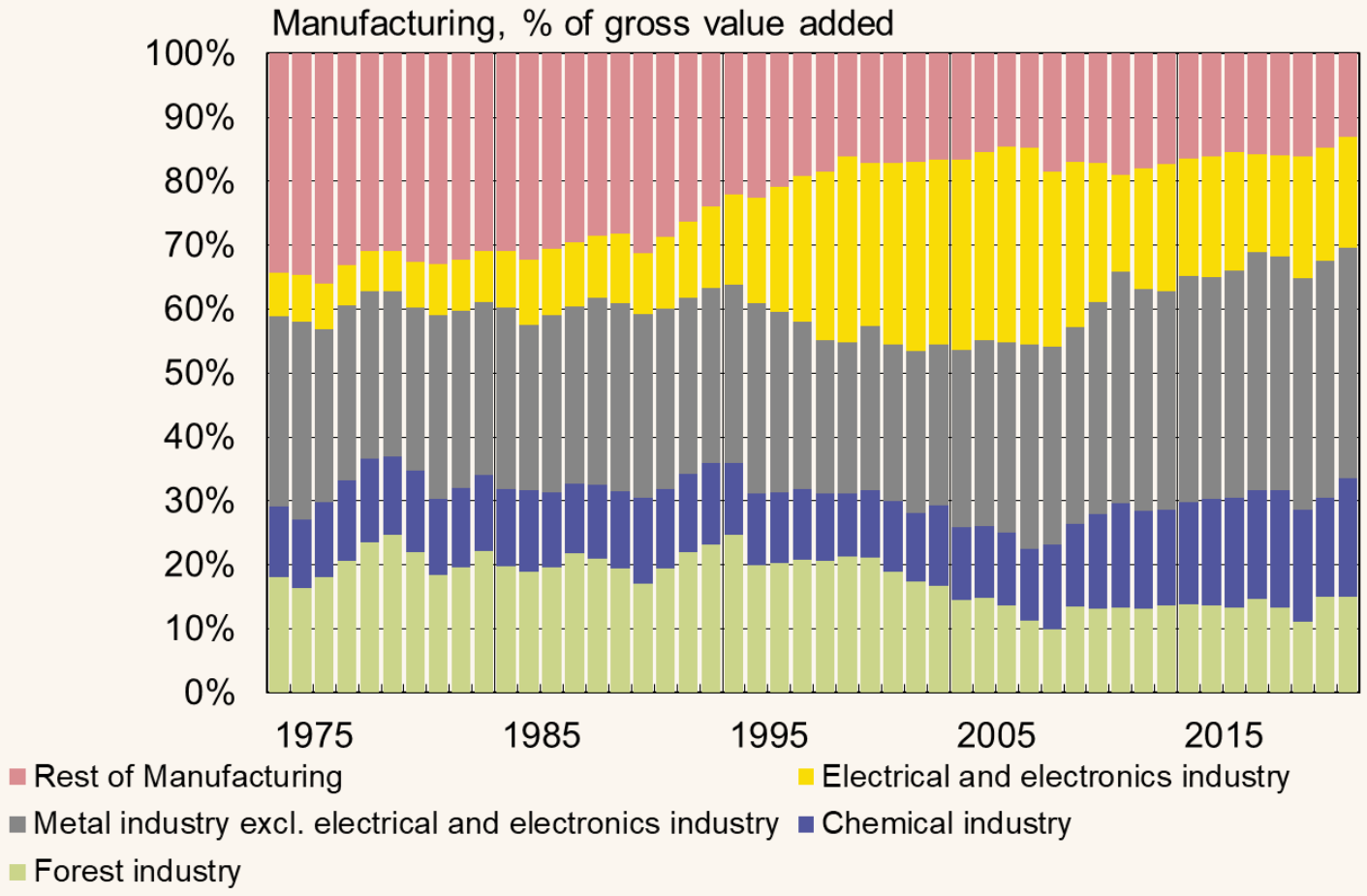
- A unique combination of cyclical and structural shocks
  - Financial crisis – foreign demand weakened
  - Structural problems in Finnish manufacturing (electronics, forest industry)

  ➡ **Large-scale destruction of previously high productivity jobs**
  - Russia: recession (and annexation of Crimea)
  - Population ageing: Working age population (15-64) shrinking since 2011

- …and slow adjustment
  - Cost competitiveness problem
  - Slow renewal of corporate sector – creative destruction mostly destructive

- New concerns
  - Shortage of skilled workforce will constrain growth in the decades to come
  - Consequences of the war for the international operating environment and Finland's comparative advantages

The structure of manufacturing changed towards less productive sectors

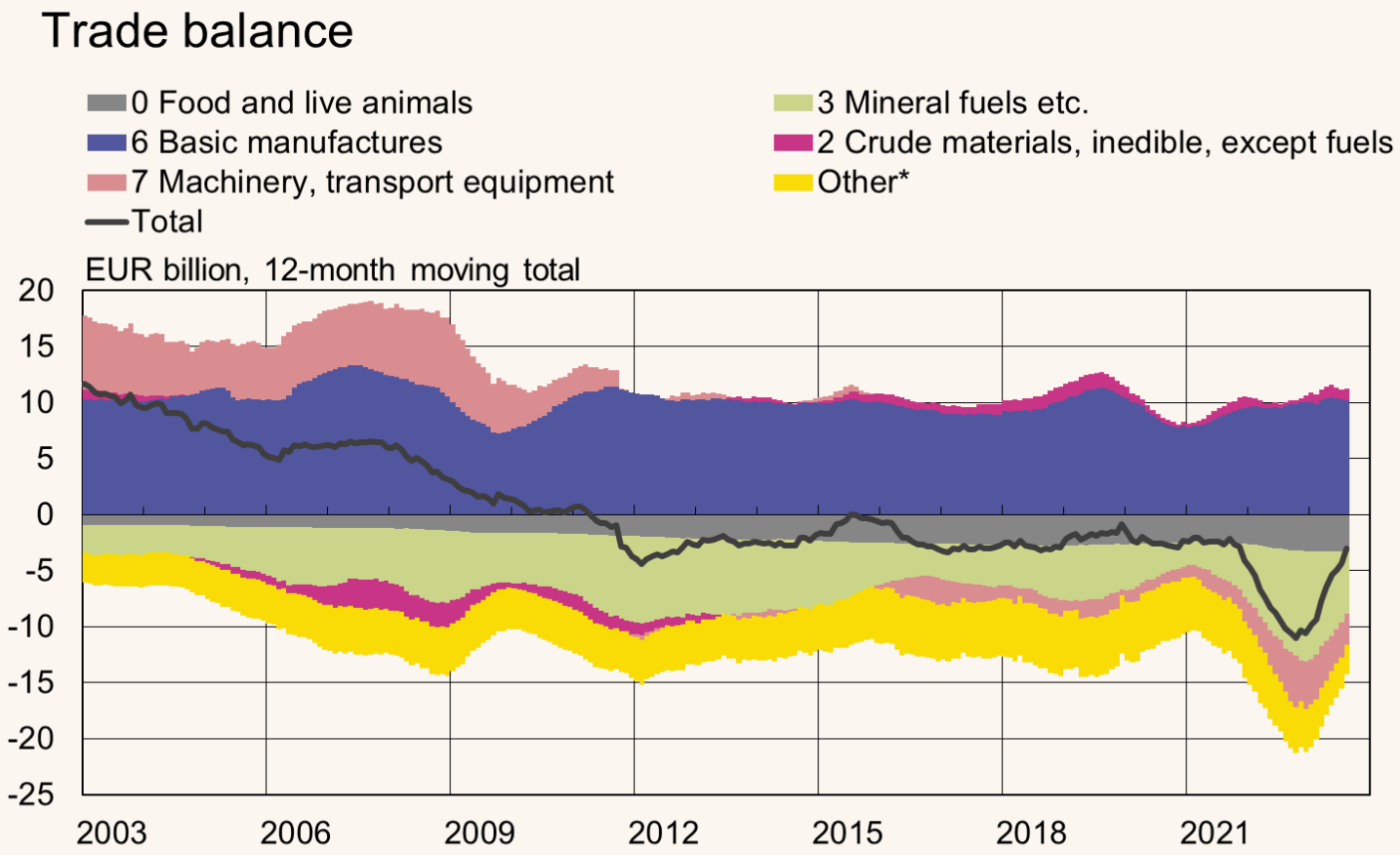


Source: Statistics Finland.

— Electrical and electronics industry's boom and bust

— Difficulties in the forest industry

Finland’s trade surplus is in low value added raw material and intermediate goods production



Source: Finnish Customs.*SITC Groups 1 (Beverages and tobacco), 4 (Animal and vegetable oils), 5 (Chemicals), 8 (Misc. manufactured articles) and 9 (Other goods).

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Cost competitiveness was lost especially in 2008-2010 - Improvement achieved with wage moderation

Unit labour costs adjusted for the terms of trade, total economy**

* 14 traditional industrial economies weighted by their share of Finnish foreign trade, in the same currency.
** Labour costs divided by national income, total economy.
Sources: European Commission, OECD, Macrobond and calculations by the Bank of Finland.

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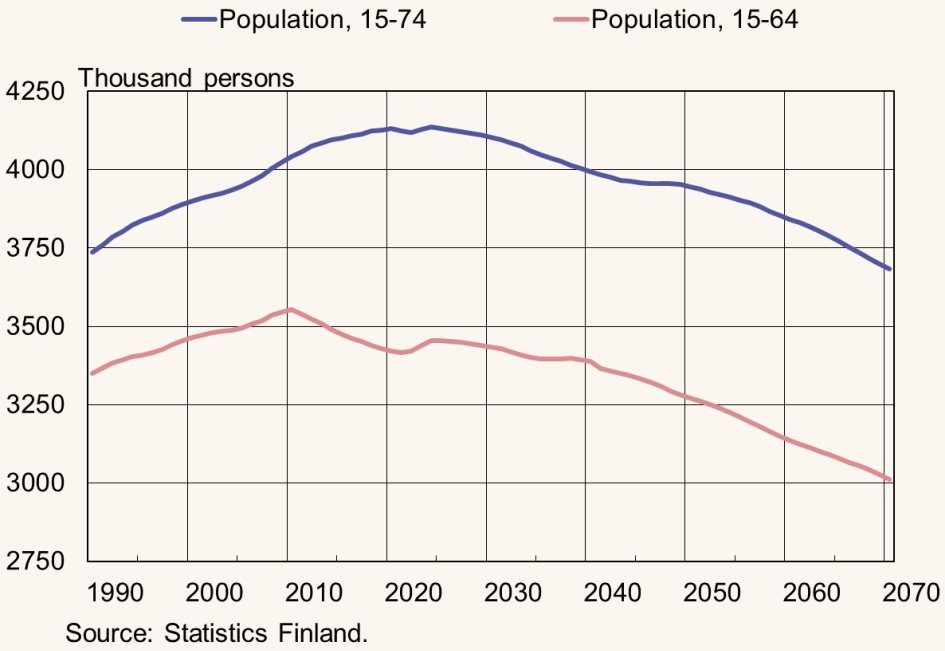
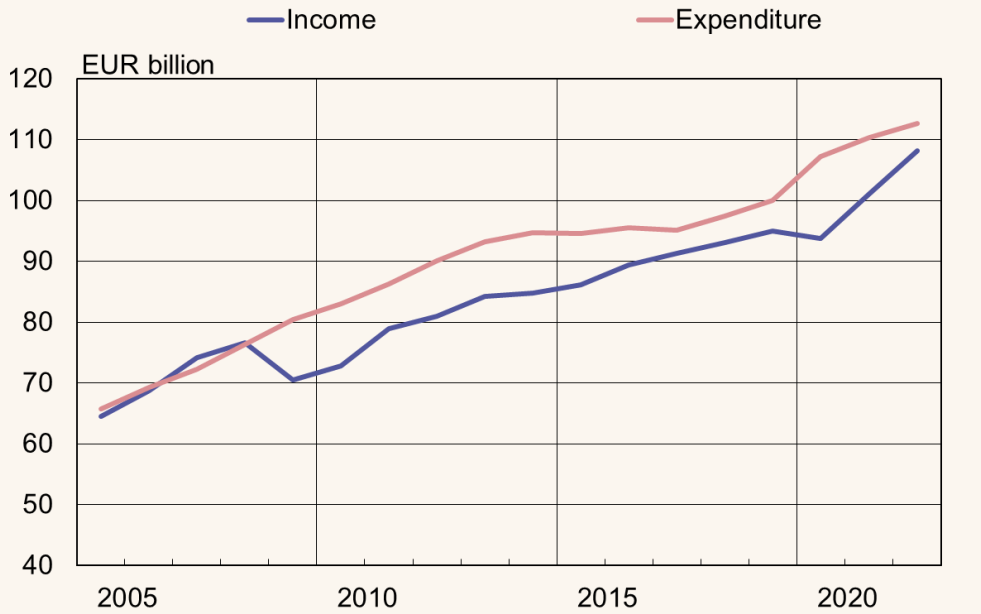
Demographics constrain growth and continue to put pressure on public finances

Working age population



Source: Statistics Finland.

General government revenues and expenditure*



Source: Statistics Finland.
* excluding earnings-related pension funds

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SUOMEN PANKKI EUROJÄRJESTELMÄ FINLANDS BANK EUROSYSTEMET

Bank of Finland’s long-term forecast suggests GDP growth will be subdued also in the future

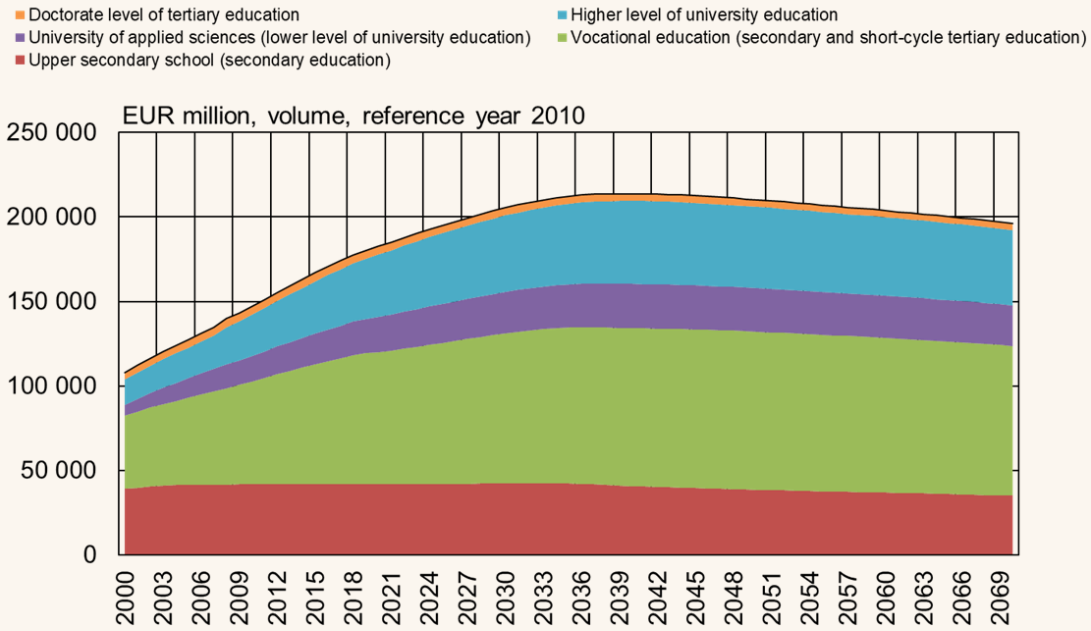
- New forecast framework that emphasizes the importance of human capital as a source of economic growth
  - Bank of Finland's long-run forecast framework with human capital (bof.fi)

- **Education** is an investment that accumulates human capital in the same way as productive investments accumulate the stock of fixed capital

- The outlook for long-term growth in Finland is weak due to the forthcoming decline of human capital driven by demography and adverse education trends.

SUOMEN PANKKI EUROJÄRJESTELMÄ FINLANDS BANK EUROSYSTEMET

Shrinking human capital weakens Finland's long-term growth potential



Sources: Statistics Finland, calculations by Arto Kokkinen (National Audit Office of Finland) and the Bank of Finland.
Method described in: Kokkinen, A., Obstbaum, M., ja Mäki-Fränti P. (2021). Bank of Finland's Long-Run Forecast Framework with Human Capital. BoF Economics Review 10-2021.

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- Human capital projected to decline if no new policies are implemented
- The trend in human capital can still be influenced
  - Investment in education and better incentives for acquiring skills
  - Higher participation rate in the labour force
  - Increasing the birth rate
  - Increased immigration of skilled workers
- Human capital instrumental for technological change
  - Innovations and R&D cannot be increased if companies do not have enough skilled labour

Summing up

- Combination of cyclical and structural shocks turned Finland into one of the worst performing advanced economies after 2008
  - Currently weak business cycle but problems are more structural
  - Past decades' weak growth achieved during mostly expansionary monetary and fiscal policies

- Cost competitiveness improved thanks to relatively slow wage growth, more focus should be put on real competitiveness

- Policy action should focus on structural reforms and fiscal consolidation
  - Availability of high-skilled workforce
  - Framework conditions for innovation and investment (vs. direct support)
  - Prioritization of public sector's central responsibilities and long-term parliamentary commitment to consolidation

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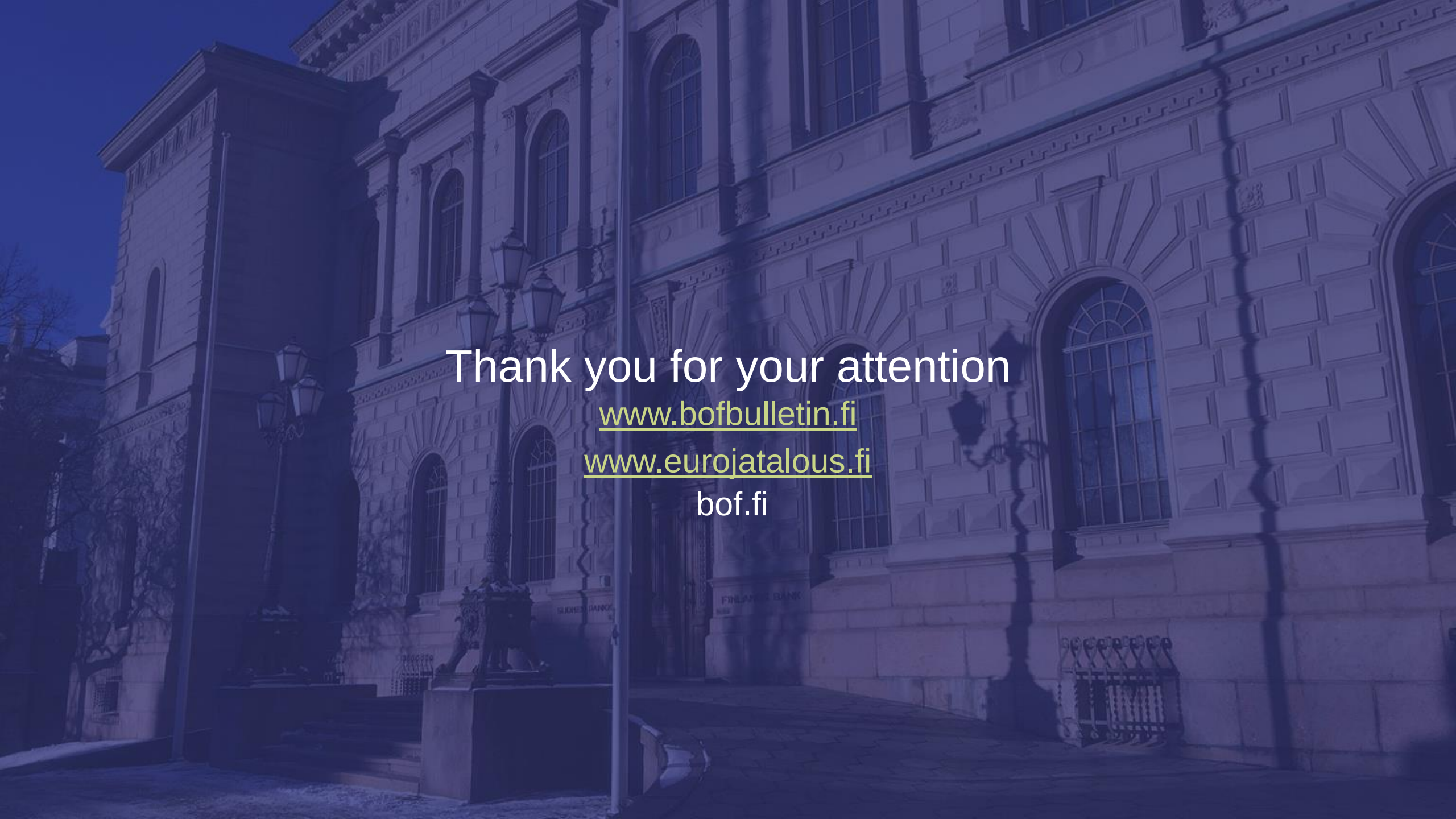
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