Finland's economy is heading for a 'perfect storm' of economic problems which risk undermining growth

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Finland has traditionally been regarded as one of the better performing economies in the Eurozone, however the country has struggled with low growth figures over the last five years. **Paul Jonker-Hoffrén** *writes that the country is facing a perfect storm of structural change in two key economic sectors (IT and forest industries), austerity policies, a potential housing bubble and the damaging effect of the euro on its exports.*

After its severe recession in the early 1990s, Finland seemed poised to be a role model to emulate. This recession in many ways looks like the current Eurocrises (in Finnish it is called 'lama' or depression). Unemployment skyrocketed to 18 per cent and GDP shrunk by some 15 per cent between 1990 and 1994. The ostensible cause, according to Seppo Honkapohja and his colleagues was both bad luck and bad politics: the bad luck was the collapse of the Soviet Union, which saw Finnish exports decline drastically; the bad politics were related to financial deregulation and improper reactions to macroeconomic trends and perhaps misguided currency policy regarding the Finnish markka, as the currency became under speculative attact in 1990.

The Finnish economy was overheating at the end of the 1980s and Finland saw a lot of foreign capital coming in (as a result of higher Finnish interest rates), resulting in inflationary pressures and a housing bubble. With the collapse of the Soviet Union there was a severe shock and the Bank of Finland held on longer to a fixed exchange rate than would have been wise, regarding the speculative attacks. In other words, Finland experienced a banking crisis like the start of the current Eurocrisis and like the 1997-1998 Asian crises.

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The description above is what happened in Finland (and to a lesser extent, in Sweden) in the early 1990s. But the elements above should sound very familiar to anyone looking at the situation of the Eurozone. In particular the influx of capital from the 'core' to the 'periphery' and the resulting inflationary pressures seems rather similar to what happened in Finland in the end of the 1980s and the onset of the recession. Also the rapid rise of unemployment, current account deficits and rising public debt are similarities. The difference is of course: one cannot devalue while in a currency union.

Finland in a perfect storm?

One feature, for which Finland is known in Europe is its very tough stance on budget discipline, in particular regarding the crisis countries that required 'bail-outs'. Many probably raised their brows when Finland successfully managed to negotiate collateral from Greece to Finland's contribution to the 'rescue' of Greece's economy.

As far as this author knows, there hasn't yet been a through study the changes in Finnish economic policy regarding the economic crisis of the 1990s and the Eurocrisis. It must be said, that the current Finnish government(s) have been very much against many of the same measures it took to survive the recession in the 1990s. For example, Finland let its currency float to get competitiveness back. Or: Finland increased its public debt to up to 70 per cent in 1997.

One issue which is similar to the current crisis, is the nationalisation and restructuring of 'bad banks.' But although also in the Finnish case this added to the public debt, there wasn't a similar policy of austerity and budget discipline. One way to look at this is that Finland had previously also devalued its currency on an almost regular basis, so from a macroeconomic policy perspective there was no immediate need for austerity. And the data on public debt show that once the Finnish economy started growing again, public debt became even less of a problem.

When we fast-forward to the present, Finland is not anymore that fast-growing country that earned its tripe-A status with a dynamic economy and low public debt. A large part of Finland's post-recession growth came from the surprising rise of Nokia and other high-tech and ICT companies. At the same time, on the wave upwards in the beginning of the euro era, many of Finland's forest industry companies made acquisitions abroad. When the exchange of the euro reached parity with the dollar and soon after became more expensive, the 'backbone' of the Finnish export industries started to experience problems, reaching a first climax in 2006, when the Voikkaa paper mill was closed for economic reasons (rather than bankruptcy or environmental reasons).

The Finnish forest industries are still in a painful process of adjustment, slowly moving towards bioproduct-industries. In the meantime, this sector has lost over 4,500 jobs, which is, relatively speaking, a very large number of jobs to lose in a very short span of time. The big shock for the Finnish economy nonetheless has been Nokia and related IT-companies. In recent years, many of these companies have shed large numbers of jobs and the 'coup de grace' was the sale of Nokia (phone division) to Microsoft. As a result, a couple of areas in Finland have been designated as 'Sudden structural change' areas, which entitles these communities to certain forms of state aid and extensive employment agency services.

However, it is not only the areas that previously hosted big IT-firms or paper mills. In recent years many firms have either laid off personnel or made them redundant altogether. Just this year, nearly 8,000 people were made redundant. Looking at the official unemployment statistics, the number of unemployed is steadily increasing; currently the unemployment rate is at 7 per cent. At the same time, the number of job openings has been rather stable. The number of long-time unemployed (meaning unemployed continuously longer than one year) is rising; currently at roughly 92,000. The number of under-25 unemployed is currently 52,000 and still rising.

Although Finland has a small population, these numbers are quite dramatic, because at the moment there does not seem to be any sector which is growing in such a way as to absorb the unemployed. In particular local communities (i.e. cities, conglomerations) have been in the news with redundancies, shedding personnel in quite large numbers. One reason for this is that in Finland communities are often the main responsible actor for the execution of social and health policies. In the context of the Finnish austerity policies, this means that the budgets of communities are squeezed to such an extent that they have to shed labour in order to achieve a balanced budget.

The policy discussions in Finland are framed in the context of extreme debt-averseness on the one hand and competitiveness on the other hand. The former is reflected in on-going budget squeezes. In Finland there actually was a headline by the National Broadcasting Company's news service that said "Debt levels approaching the horror levels of the 1990s!" – meaning nearly 60 per cent. The latter issue marks the divide between domestic and international firms – the latter, with a supportive role for the export-sector unions, managed to keep wage increases absolutely minimal.

The reasoning is that Finnish labour costs have risen too much relative to Germany's, and that therefore the Finnish economy lost competitiveness. In some sense this is true, but Germany has for many years engaged in wage suppression and therefore undershot the norms of the Stability and Growth Pact. Finland, therefore, is now voluntarily engaging in internal devaluation, with all the expected results we also know from Greece and Spain:

rising unemployment, rising public debt ratio and shrinking GDP.

Besides domestic austerity politics, which exacerbate the unemployment crisis, Finland suffers (as most of Europe does) from a lack of demand. Until recently, Finland to a quite large extent managed to hang on by virtue of domestic demand growth. However, austerity and unemployment squelch domestic demand, which in Finland may have been built on private debt. Finland has a quite high level of private indebtedness, most of which is due to mortgages. It is quite possible that at the moment Finland's housing bubble, like the Dutch one before, is bursting. The difference is that the trigger is unemployment and economic malaise rather than bank trouble. It will take time to see whether housing prices actually drop like a stone, but at the moment there are no factors in Finland that warrant increasing housing prices.

All in all, Finland is in many ways in a perfect storm. It experiences structural change in two key economic sectors (IT and forest industries), voluntarily implements austerity policies, has a high likelihood of a bursting housing bubble and on top of this is facing a brake on exports – an expensive euro. The current Prime Minister of Finland promises not 'misery' but 'blood, sweat and tears' as a factor in economic politics. And at the moment all economic research institutes are again revising downwards the prospects for growth, so the near future for Finland does not look good, economically speaking. Fortunately, research, education, ICT-infrastructure and innovation strategies are still top level.

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Note: This article gives the views of the author, and not the position of EUROPP – European Politics and Policy, nor of the London School of Economics.

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