FINLAND IS IN EURO-TRAP.

In 1997, when I was working in Helsinki School of Economics, my colleague came from a meeting, and told “Finnish politicians have decided to take Finland to euro. It is strange that in Sweden they had the same analysis as we, but Swedes have decided to keep own currency”. Before and after that I had looked news and read newspapers to figure out the argumentations supporting joining the euro-area. At that time Paavo Lipponen was prime minister and he told continuously that “We have to be in the tables, where important decisions are made”. I was thinking that sitting in the decision tables does not matter so much, because big countries anyhow make decision. They do not listen small countries. Other pro-euro argumentations were connected to tourism and trade. “It is easier to travel when you do not have to change currencies” and “Firms can avoid costs connected with changing Finnish Markka to other currencies”. I never had any difficulties in money exchange. Only small trouble was spread between selling and buying foreign currency. But I do not travel weekly abroad. Furthermore, firms can shelter against currency volatility using forward and options arrangement. Up to this day I have not seen any studies connecting to costs of using forward and option arrangements.

Let us compare the latest depression in markka- and euro-era. In the figure 1 there is the time series of real income (real gross domestic product). Historical time series is available from 1860 onwards. Era of own currency is blue sky in the figure 1. There were booms and busts, but the real income before euro-era always converged to trend (potential gross domestic product).

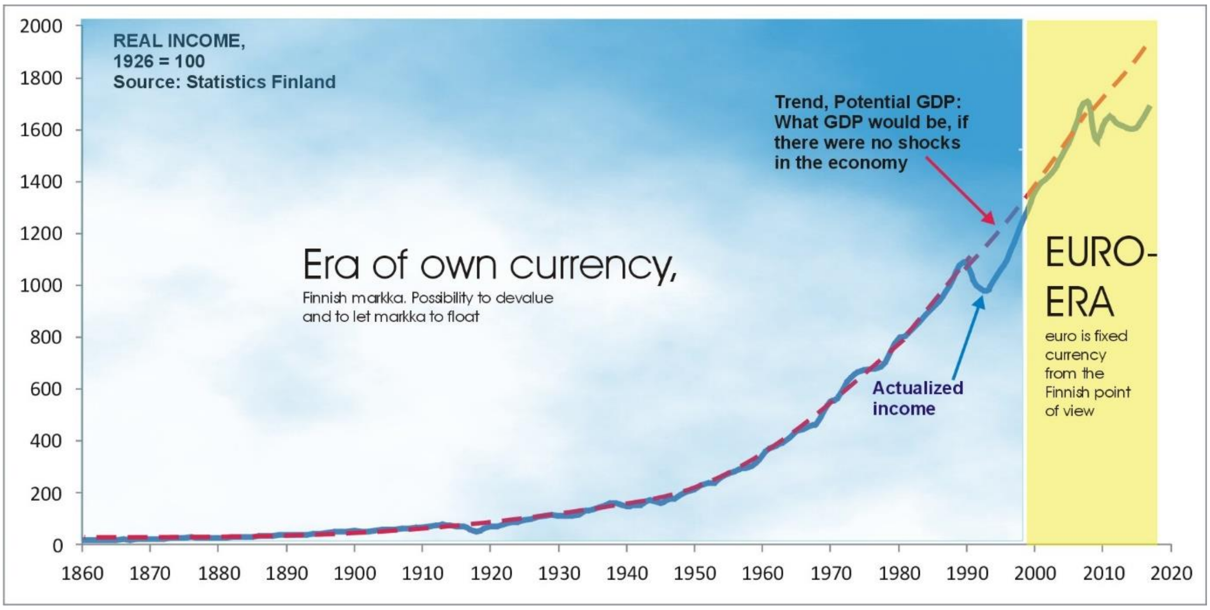


FIGURE 1. REAL INCOME AND ITS TREND 1860 - 2018

ADJUSTMENT OF FINNISH ECONOMY IN MARKKA ERA, WHEN THERE WERE FLEXIBILITIES IN FINNISH ECONOMY.

Let us take a closer look of the depression 1990 – 2001 (figure 2). In the beginning of the slump the gap between trend and realized real income grew. After that gap begin to close and in some years growth rates (on the horizontal axis) were big by the magnitude of 5 % - 6 % and convergence to the trend was guaranteed due to the flexibilities during that time.

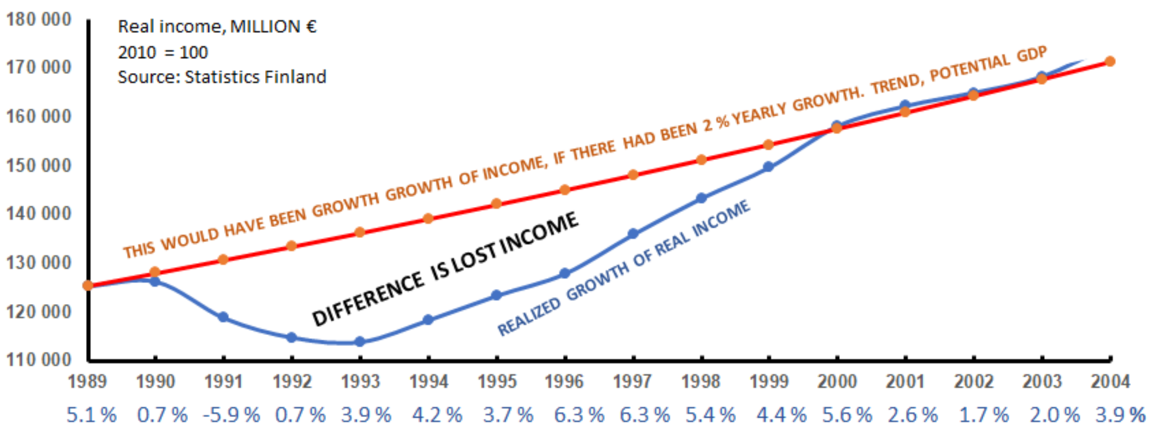


FIGURE 2. DEPRESSION 1990 – 2000.

There were flexibilities due to possibility to devaluate or let markka to float, interest rate and wages were reacting to dismal economic environment. During the slump that started 1990 real devaluation of markka against important trade partners was some 30 percent. Unemployment rate soared up to 11 % - 16 % and due to that wages did not rise. Both devaluation and wage restraints helped to gain competitiveness that boosted exports and began to drag economy up from depression abyss. In the beginning interest rates rose to double digit percentages, but after a while they started to subside to more tolerable levels that helped to boost investments. All in all, economy recovered and in the year 2000 real income hit the trend. Flexibility of exchange rate, wages and interest rate guaranteed that like before. Euro changed it all.

LACK OF ADJUSTMENT OF FINNISH ECONOMY IN EURO-ERA, WHEN THERE WERE FIXITIES IN FINNISH ECONOMY. FIXED EXCHANGE RATE COMBINED WITH WRONG WAGE POLICY IS THE WORST COMBINATION IN THIS UNIVERSE.

Situation after massive external shocks can be remedied quickly by devaluation. Changes in wages takes time due to resistance of trade unions. Anyhow reduction in wages is not a good idea, because the debt stays put and thus the ability to pay it becomes more difficult and there is always furious resistance from the trade unions. Of course devaluation also lowers purchasing power of wages, but not as much as required wage reduction to get competitiveness back. Devaluation affects above all price of imported goods. Devaluation is only technical operation, even though some considers it shameful. In flexible exchange rate regime that happens automatically.

In the figure 3 there is a dismal picture about Finnish economy during recent misery that started 2008. There was a double dip depression. After initial recovery, economy drooped back in the year 2012 to negative growth that lasted three years. The gap between the trend and realized real income grew. Even from 2015 the growth has been meagre. It should be some 6 % - 8 %, because the bigger is the gap the faster economy should grow, if there are exchange rate, wage and interest rate flexibilities.

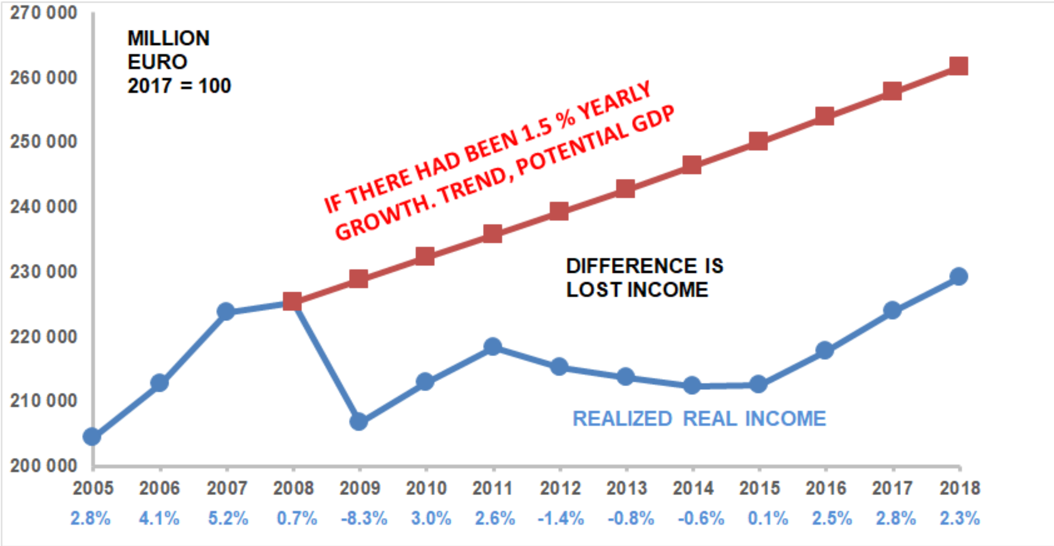


FIGURE 3. DEPRESSION 2008 ONWARDS.

CIRCUMSTANTIAL EVIDENCE: THE WAGE FORMATION THAT IS INCOMPATIBLE TO EURO-ERA ARE THE GUILTY ONES.

Euro is fixed currency from the standpoint of Finland. Finnish booms and busts do not affect euro's value. Furthermore, trade unions and employer associations do not take into account the requirements that fixed exchange rate places on wage formation. Wages rose from about 6 % in the year 2008 due to some strikes and about 4 % in the year 2009. Competitiveness went down the drain.

During prevailing catastrophic economic situation former cabinet tried to make laws that would help the situation: more working hours without compensation and some wage restraints. Some of the reforms were rolled back, because of the angry demonstration by the unions. Due to threatening big budget deficits, cabinet had to make budget cuts that actually put downwards pressure on income. Cabinets before former cabinet (Jyrki Katainen and Alexander Stubb cabinets) did not make any necessary reformation. That was due to too wide political base of the cabinet: from conservatives to leftist parties. Always somebody was putting brakes on reforms.

I have circumstantial evidence, when I put the blame on euro and wage policy. In the figure 4 there is the development of real income in Nordic countries. From 2011 Finland has dropped from the Nordic wagon. The only major difference between Nordic countries is euro. Only Finland is in the euro-area. Others have flexible exchange rate.

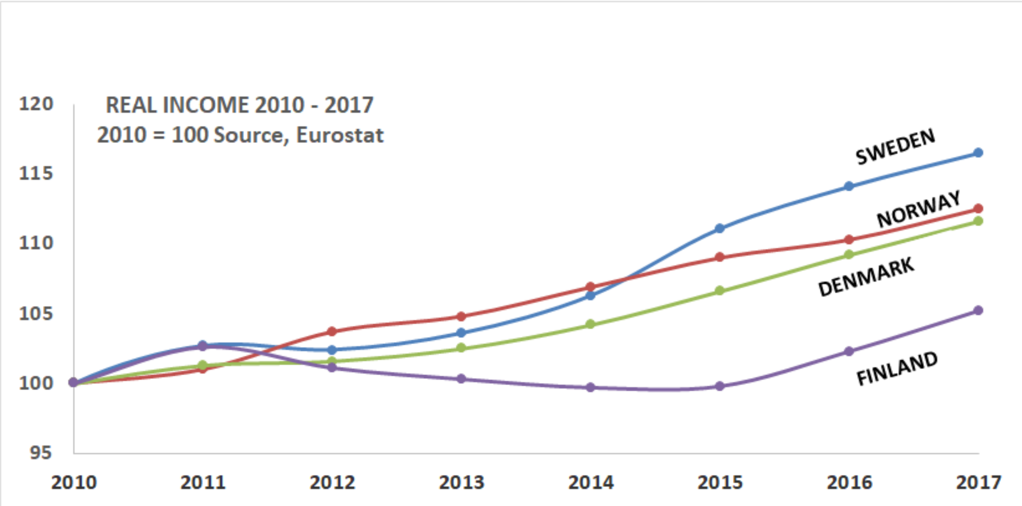
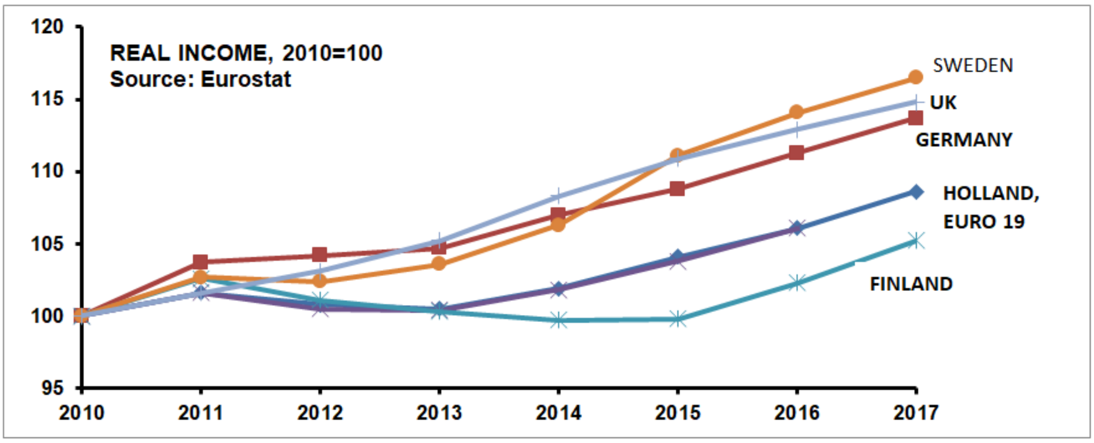


FIGURE 4. REAL INCOME OF FOUR NORDIC COUNTRIES.

Another circumstantial evidence comes from the trade. In the figure 5 there are time series of the real income of the biggest trade partners of Finland. According to traditional view Finnish export should rise when real incomes of trading partners rise. According to figure that has not happened. Prices has strong influence on trade. If prices have risen too fast, competitiveness of the Finnish economy suffers. And wages are part of the prices.



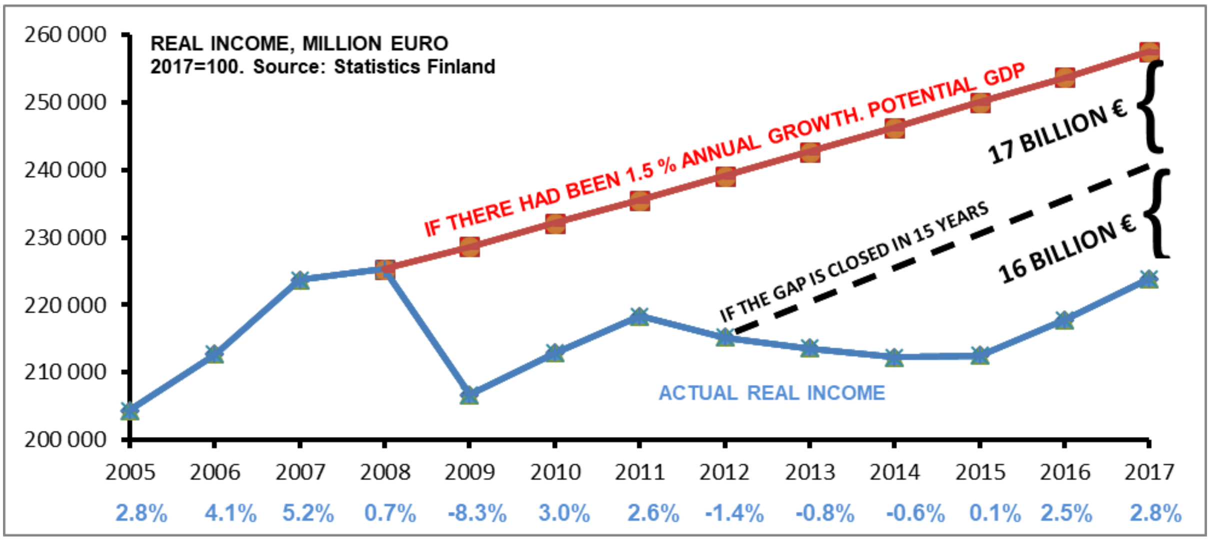
VERDICT OF THE JURY

Verdict of the jury: The guilty ones to miserable performance of the Finnish economy are euro and the incompatible wage policy. Penalty. It is not a proper act put one' s finger on the market forces. Penalty should put on those who took Finland to Euro and made catastrophic wage policy. Some say that there is light at the end of the tunnel, but others say that the final catastrophic train is coming on you at full speed and the result is a crash.

Also ECB has part of the blame of overall misery. ECB has forgotten old monetary policy that says "You can lead a horse to water, but you cannot force him drink." Now interest rate is negative, and we can only ask Draghi by the lyrics of a song "How low can you go?"

HOW MUCH IS LOST DUE TO THE FIXED EXCHANGE RATE AND WAGE POLICY THAT IS INCOMPATIBLE WITH IT?

In the year 2017 the loss (gap between trend and realized income) was about 30 000 000 000 euros. Part of that is due to shock from outside. I have estimated that the loss due to euro and wrong wage policy is about 16 000 000 000 euros (figure 6) Compare that with the Finnish budged that is about 50 000 000 000 euro. To retell Hamlet "Something is rotten in the state of Finland".



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