Fiscal policy in Finland during the COVID-19 crisis

ABSTRACT

Countries all over the world have engaged in active fiscal policy during the COVID-19 crisis. The role of fiscal policy in providing economic stimulus has been elevated, since many central banks have been constrained with the zero lower bound on interest rates. Finland is no exception in this respect, and unprecedented fiscal measures have been taken in order to soften the initial shock and to stimulate aggregate demand. This paper reviews the main fiscal measures taken in Finland, compares them to other countries' fiscal responses and discusses some preliminary conclusions. The following is a brief summary of the more detailed report prepared for the Economic Policy Council by Huhtala (2020).

FINNISH FISCAL RESPONSE

To date (September 24th), the Parliament has approved four supplementary budgets, which in total increase the government's expenditure by EUR 9,601 billion and lower the estimated revenue by EUR 7,073 billion. This results in an increase of net borrowing by EUR 16,674 billion. Most of these changes in revenue and spending are direct consequences of economic developments caused by the COVID-19 crisis. Focusing only on budgetary measures, however, understates the total scope of fiscal measures. Several considerable measures have been taken that do not have direct effects on the government's budget.

Most of the support measures implemented have been targeted at firms, as is evident based on table 1. To give a more detailed view of these measures, I will briefly list the main contents included in each row of the table.

- **Subsidies:** These measures include general subsidy programs through Business Finland (EUR 980M) and ELY Centres (EUR 425M), and the business cost support program (EUR 300M). In addition, support for sole entrepreneurs through municipalities (EUR 250M) and support for businesses in the food and beverage service sector (EUR 171M) are included. The rest of the subsidies are smaller and more targeted to certain industries.
- **Loans and capital investments:** These measures include purchases in corporate commercial paper market by the Bank of Finland (EUR 1 000M) and the State pension fund of Finland (EUR 1 000M), capital investments for Finnair (EUR 700M) and Finnish Minerals Group (EUR 150M), and a EUR 400M capital investment for Finnish Industry Investment Ltd (Tesi) to start a stabilization program for mid-sized companies.
- **Guarantees:** Increase in Finnvera's authorization to grant guarantees for loans (EUR 10 000M), a state guarantee for Finnair (EUR 600M) and a state guarantee for important shipping companies (EUR 600M) are included.
- **Changes in taxation and pension contributions:** These measures include delays in tax revenue caused by the changes in tax payment arrangements (EUR 753M) and support for municipalities

* Tuukka Huhtala, Master's student at Turku School of Economics (University of Turku), email: tuukka.o.huhtala@utu.fi. This paper is based on my three-month internship and does not represent the official views of the Economic Policy Council. I would like to thank my supervisor Seppo Orjasniemi for his useful comments and advice throughout the project.

for their share of delayed tax revenue (EUR 547M). In addition, a temporary reduction of employers' pension contributions by 2,6 percentage points (EUR 1 050M) is included.

- **Other:** The largest measure in this category are the lower capital requirements for financial institutions set by the FIN-FSA, which are estimated to increase private lending capacity by EUR 30 000M. In addition, an authorization for the Financial Stability Fund to borrow a maximum of EUR 2 000M to overcome possible challenges facing the deposit guarantee is included.

Support measures to households have also been extensive during the crisis, even though most of the effect has come through automatic changes in social security expenditure. In evaluating economic policy, it is useful to make a distinction between discretionary measures and automatic responses of the social security system, as is done in table 1.[1] Discretionary measures include mostly temporary changes to unemployment benefits, such as making unemployment benefits available for entrepreneurs (EUR 160M), the removal of waiting period and the relaxation of the qualifying work requirement (EUR 102M). Other measures included are, for example, a temporary financial assistance due to an epidemic outbreak (EUR 94M), an increase in the amount one can earn without it affecting their unemployment benefits (EUR 13M) and a relaxation of the conditions of commuting and relocation allowance (EUR 25M). An additional EUR 124M is caused by extending these changes to the end of this year.

Table 1: Support measures to firms and households

Firms			**Households**	
Form of Support	**EUR million**		**Form of Support**	**EUR million**
Subsidies	2 249		Discretionary measures	561
Loans and capital investments	3 777		Automatic changes in the social security expenditure	1 210
Guarantees	11 200			
Changes in taxation and pension contributions	2 350			
Other	32 000			

As a part of the fourth supplementary budget in June, an economic stimulus package was passed by the Parliament. The package aims to stimulate aggregate demand, improve long-term growth and prevent climate change. This package's measures are hard to reconcile between different sectors, so it is presented separately in table 2.[2]

[1] The table is modified from the original report to exclude measures that are not direct income support for households.

[2] Note that the stimulus package includes some measures that are also considered in the first two tables.

Table 2: Economic stimulus package

Economic stimulus package	
Category	**EUR million**
Investments, infrastructure and construction	1 641
Support to firms	1 245
Innovations, knowledge and welfare	1 281
Welfare program for children and the young	214
Support to municipal economy	1 400
Total	**5 781**

Investments, infrastructure and construction: This category includes substantial investments especially to roads, railways and public transport. Some of these investments, however, are uncertain as they depend on Metsä Group's possible investment decision and on so called MAL-agreements. In addition, this year's actual budgetary effect of this category is estimated to be only EUR 362M, which indicates that the bulk of planned investments take place over a longer horizon. This category also includes support for housing construction and several green projects.

Support to firms: This category's measures have already been considered in table 1. Largest components are the business cost support program (EUR 300M), second capital injection for Tesi (EUR 250M) and capital injection for Finnish Minerals Group (EUR 150M). Finnish Minerals Group also received an authorization of EUR 300M to be used on battery development. Smaller components include, for example, increases to the general subsidy programs, support for agriculture and support for sustainable growth.

Innovations, knowledge and welfare: The largest component in this category are changes to unemployment benefits (EUR 812M), which were already considered with the measures targeting households. Second largest component is the temporary increase in the number of students accepted to higher education (EUR 124M). The rest of the measures are smaller and target for example research, education and well-being. The time horizon for the measures in this category is generally quite long.

Welfare program for children and the young: This category includes support for early childhood education and general education (EUR 116M). Smaller components include support for work-related training, vocational education and free-time activities.

Support to municipal economy: These measures include EUR 200M support for health care districts as compensation for the costs caused by the COVID-19 crisis. The rest is assigned for municipalities to support their various functions. Many municipalities faced financial difficulties even before the crisis, which makes supporting them a crucial task for the government.

INTERNATIONAL COMPARISON

It is natural to compare the Finnish fiscal response to the COVID-19 crisis with other Nordic countries' (excluding Iceland) responses. Overall, the Nordic countries have responded to the crisis very similarly: most measures have been taken through existing systems and the bulk of measures has been targeted to firms. There are, however, some notable differences I will briefly discuss here. In addition, a few interesting examples from other parts of the world are mentioned.

The information on this section is mostly based on OECD (2020a), OECD (2020b) and IMF (2020). For more information, see the original report.

It must be noted, however, that the comparison of fiscal measures between countries is very difficult. In many cases, different sources report somewhat different numbers and the information available is mostly incomplete. This means that especially quantitative comparisons are prone to errors, and therefore I have focused on qualitative comparisons.

Firms

The forms of support to firms have been very similar across the Nordic countries. Supporting private borrowing by granting guarantees for loans and lowering capital requirements for financial institutions are measures that have been used extensively worldwide. In addition, all Nordic countries have implemented general subsidy programs to strengthen firms' liquidity across industries. A straightforward comparison shows that the relative size of these programs has been smallest in Finland. On the other hand, Finland has the largest GDP-share of general state guarantee programs (see table 3). It is difficult to evaluate what is the right balance between subsidy and guarantee programs. Subsidy programs have larger budgetary effects, but they also support firms more directly and are therefore more efficient in providing liquidity.

More interesting differences arise when one focuses on the measures aiming to lower firms' costs. Rental costs in particular have been a target of support measures in many countries. In Australia, for example, rental payments have been lowered (with certain conditions) proportionally in response to the decline in the tenant's turnover. This kind of system ensures that the landlords carry part of the tenants' losses and therefore leads to a more equal distribution of the adverse effects of the crisis. In the Nordic countries, measures directly targeting rental costs have not been common. The only Nordic example is from Sweden, where rental payments were temporarily lowered in some vulnerable industries.

The reason for the absence of these measures in the Nordics is that the general subsidies can be used to cover rental costs. However, in Finland, the business cost support came available only in the beginning of July, whereas other Nordic countries announced similar programs in March and April. In addition, the Finnish business cost support has not been used to the extent expected: currently EUR 121M of the budgeted EUR 300M has been granted to firms, with approximately 72% of applications rejected.

Table 3 compares the total amounts of different support measures in Nordic countries relative to this year's predicted GDP from the AMECO database. The term "general" refers to programs that have been available for firms generally across industries.[3] This restriction limits the analysis, since significant support measures have been targeted to certain industries. It is, however, necessary in order to tackle the problems of quantitative comparisons mentioned earlier. In addition, state loans and capital injections exclude the commercial paper purchases by Bank of Finland, as corresponding measures in other Nordic countries are a part of their autonomous monetary policy.

[3] For example, the Finnish general subsidy programs include the support through Business Finland and ELY Centres, and the business cost support program. Similar programs from other Nordic countries are considered in the comparison.

Table 3: Support to firms in Nordic countries, relative to GDP.

	Finland	Sweden	Denmark	Norway
General state guarantee programs, % of GDP	4.37 %	3.15 %	2.82 %	1.81 %
General subsidy programs, % of GDP	0.75 %	0.82 %	2.97 %	1.63 %
State loans and capital injections, % of GDP	1.15 %	1.64 %	0.61 %	1.64 %

Taxation

A key observation is that tax reliefs by reducing the actual tax rates have been largely absent during the crisis in Finland, Sweden and Denmark. Changes in taxation have focused mainly on more flexible payment arrangements and temporary refunds of already paid value added taxes (VAT). In Denmark, the temporary refunds have been interest-free and in Sweden the interest rate has been 1,25%. These lower rates make it more appealing for firms to make liquidity-strengthening tax payment arrangements, compared to the 2,5% rate used in Finland.

Norway's government, on the other hand, has reduced rates on several taxes, including the reduced VAT, the fuel tax and the employer's tax. Reductions in the VAT rate have been implemented in many other countries as well, such as the United Kingdom, Belgium and Germany. The VAT reduction in Germany has been particularly extensive: the standard VAT rate has been temporarily reduced from 19% to 16% and the reduced rate from 7% to 5%. Montag et al. (2020) study the effects of these reductions by analyzing fuel prices. They find that the effects have been rapid and significant.

The use of tax cuts in stimulating the economy is supported by recent research on fiscal multipliers (see Ramey 2019). Many studies have found that tax multipliers are possibly larger than spending multipliers, which would encourage more extensive use of tax measures in stimulating the economy. It needs to be noted, however, that these findings are dependent on many factors, and therefore it is not clear if tax multipliers are generally larger than spending multipliers in Finland. Especially with consumption taxes, such as VAT, the multiplier is highly dependent on the consumers' marginal propensity to consume, which can be affected by the uncertainty related to the COVID-19 crisis. In other words, it is possible that the present uncertainty causes consumers to increase their precautionary saving in response to a consumption tax cut. In addition, the effects of a VAT cut depend on market characteristics, such as competition and the elasticity of demand.

Although VAT cuts have been the most common tax cuts during the COVID-19 crisis, they are certainly not the only option. In addition to the measures in Norway, several countries have made reliefs to, for example, property and income taxes. Tax cuts in general present a variety of options to stimulate the economy through different channels and therefore should be considered as a part of expansionary fiscal policy.

Households

Support measures aimed at households have been quite similar in the Nordic countries. Discretionary measures have been mostly taken through existing social security systems by easing their conditions and extending coverage. A large share of support has come through the automatic functioning of the social security system. In Finland, these automatic changes in social security expenditure account for approximately 68% of total income support to households during the COVID-19 crisis (see table 1).

In Sweden, Denmark and Norway, sickness benefits have been made available starting from the first day of sickness, which is a pre-existing condition in Finland. Sickness benefits have also been extended to cover the self-employed in all Nordic countries.

All Nordic countries have implemented a program supporting short-term temporary layoffs in order to enable firms to reduce personnel costs and to prevent permanent layoffs. These programs are thus meant to support both firms and households. In Sweden, the government has subsidized short-term layoffs so that firms can reduce their wage costs by 50–70%, while employees still receive approximately 90% of their normal salary. In Denmark, for firms that are forced to lay off more than 30% of their employees or more than 50 employees, the government will compensate 75% of the employees' wages. The firms must commit not to permanently lay off employees for financial reasons during the support period and to cover the remaining 25% of the employees' wages. Thus, employees receive full salary during the short-term layoff. In Norway, employees experiencing short-term layoffs have been guaranteed full wage compensation from the government during days 3–20 of the layoff period. First two days have been compensated by the employer. Starting from September, the employer-paid days are increased to 10 and the wage compensation scaled back from 100%.

Based on this information, it is clear that in other Nordic countries temporarily laid off employees' losses in income have been compensated more fully than in Finland. Here unemployment benefits have been made available starting from the first day, but they do not normally cover such a large share of income. For example, the compensation rate for a single person with an average wage and no children is 55% of the previous in-work income (OECD Statistics).

Another difference between Nordic countries is that Sweden, Denmark and Norway have all supported students in various ways. These measures include a temporary removal of income ceiling for student aid in Sweden, a one-time cash transfer of DKK 1 000 (approximately EUR 134) for students in Denmark and an increase in the amounts of student loans and grants available to students who have lost work income in Norway. No such measures have been taken in Finland.

Many countries have also supported households using direct transfer payments. In Japan, for example, all permanent residents have received a cash transfer of JPY 100 000 (approximately EUR 800). In the United States, the government has supported households through so called *Economic Impact Payments* that are available to all U.S. citizens and permanent residents. The amount of the payment is smaller for high-income households, but the standard payment is USD 1 200 (approximately EUR 1 010). Parker et al. (2013) study the effects of similar transfer payments in the United States during the global financial crisis. They find that the payments had a significant effect on households' consumption. In Nordic countries, direct transfer payments have not been used extensively, which is consistent with the fact that Nordic countries have comprehensive social security systems.

PRELIMINARY CONCLUSIONS

In conclusion, Finnish fiscal measures during the COVID-19 crisis are mostly quite similar to other Nordic countries' measures. This brief summary has focused mainly on the observed differences and therefore understates the similarity between Nordic countries' measures. In addition, some monthly statistics support the view that domestic fiscal measures have succeeded in strengthening firms' liquidity and therefore have prevented bankruptcies.[4]

On the cost side, firms have been supported especially by reducing employer's pension contributions and by making short-term temporary layoffs easier. Short-term layoffs have been used extensively in Finland: the number of temporarily laid off employees grew over 770% between February and April. It is therefore reasonable to assume that, because of these measures, a large number of permanent layoffs have been avoided, which supports both households and firms. It must be noted, however, that the effects of these short-term layoff programs cannot yet be thoroughly evaluated. Following months will show how well firms are able to restore their functions and whether large-scale layoffs are still needed. It is a general concern that the continuing financial difficulties in firms will eventually result in large increases in unemployment.

A key observation from the Finnish fiscal response is that tax cuts have not been used to stimulate aggregate demand. Norway is the only Nordic country that has used tax cuts extensively but there are also many other examples from Europe. For the reasons discussed earlier, it is largely unclear whether tax stimulus would be effective in Finland. Several recent studies indicate that tax multipliers could be larger than spending multipliers, but these results depend on many factors (see Ramey 2019). In any case, tax cuts should be considered if there is a need for additional fiscal stimulus.

The economic stimulus package also contains some features that need to be discussed. Firstly, a large share of measures focuses on long-term structural objectives rather than short-term fiscal stimulus. Long-term measures are also important, but for effective stimulus, the measures should have relatively fast effects on aggregate demand. Secondly, the public investments contain significant uncertainty and it is unclear how quickly these projects will be executed. This year's budgetary effect of these measures is much smaller than the total authorized amounts for the investments, which would indicate that most of the effects will be realized over a longer time period.

When considering Finnish fiscal measures, one must also consider the problem of fiscal sustainability gap, which is driven by aging population. This gap constrains fiscal policy (at least in the long run) by increasing the debt to GDP -ratio over time and could lead to a worsening in the long-term growth perspectives. It is therefore crucial to devise a credible plan to overcome this problem and to stabilize the public debt ratio. The importance of such a plan is highlighted by the Economic Policy Council (2020) and Vihriälä et al. (2020).

[4] Bankruptcy statistics are not comparable to previous years because of a temporary change to the Bankruptcy Act (see the original report for more information and statistics).

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