The Telegraph

Finland's depression is the final indictment of Europe's monetary union

Finland has lost a quarter of its industry since 2008 even though it is the poster-child of EMU competitiveness

President Risto Ryti was Finland's great inter-war economist. He was unfairly sentenced to hard labour as a war criminal even though the Bank of England tried to save him Photo: Getty Images

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9:27PM GMT 18 Nov 2015

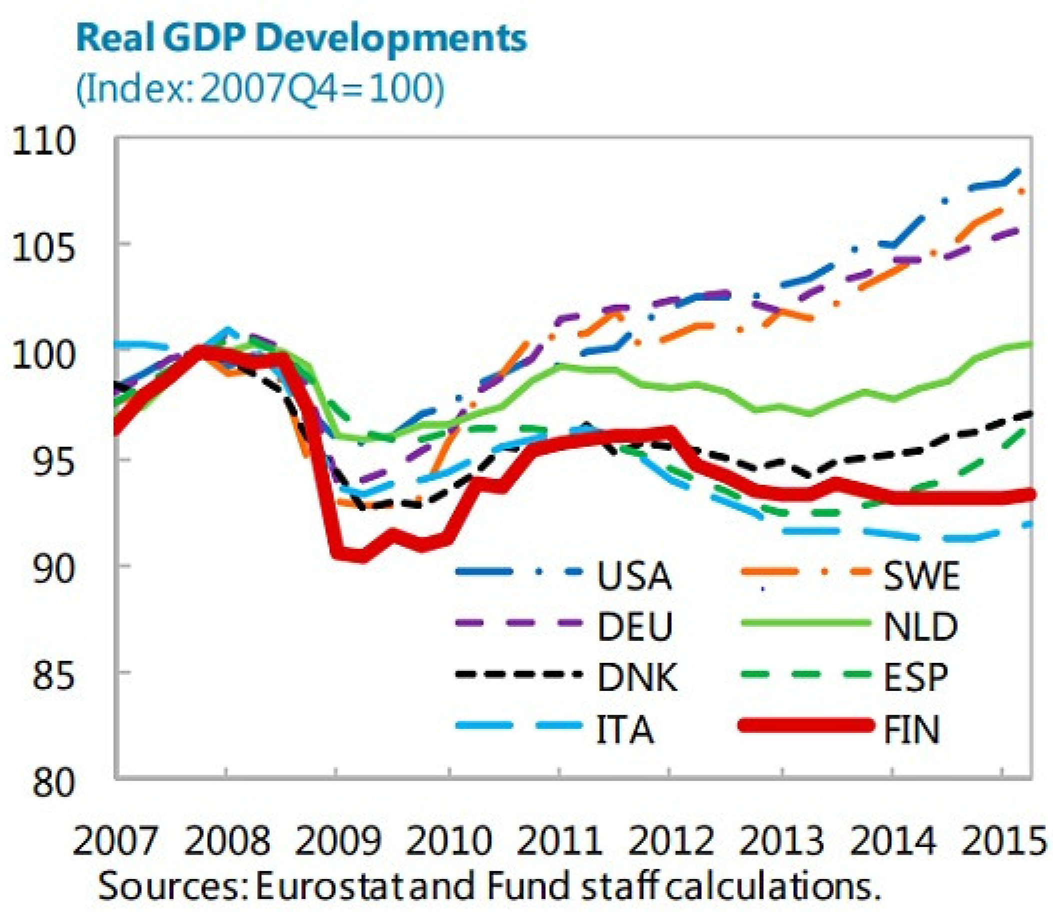
525 Comments

Finland is sliding deeper into economic depression, a prime exhibit of currency failure and an even more unsettling saga for theoretical defenders of the euro than the crucifixion of Greece.

A full six-and-a-half years into the current global expansion, Finland's GDP is 6pc below its previous peak. It is suffering a deeper and more protracted slump than the post-Soviet crash of the early 1990s, or the Great Depression of the 1930s.

Nobody can accuse Finland of being spendthrift, or undisciplined, or technologically backward, or corrupt, or captive of an entrenched oligarchy, the sort of accusations levelled against the Greco-Latins.

The country's public debt is 62pc of GDP, lower than in Germany. Finland has long been held up as the EMU poster child of austerity, grit, and super-flexibility, the one member of the periphery that supposedly did its homework before joining monetary union and could therefore roll with the punches.



Finland tops the EU in the World Economic Forum’s **index of global competitiveness**. It comes 1st in the entire world for primary schools, higher education and training, innovation, property rights, intellectual property protection, its legal framework and reliability, anti-monopoly policies, university R&D links, availability of latest technologies, as well as scientists and engineers.

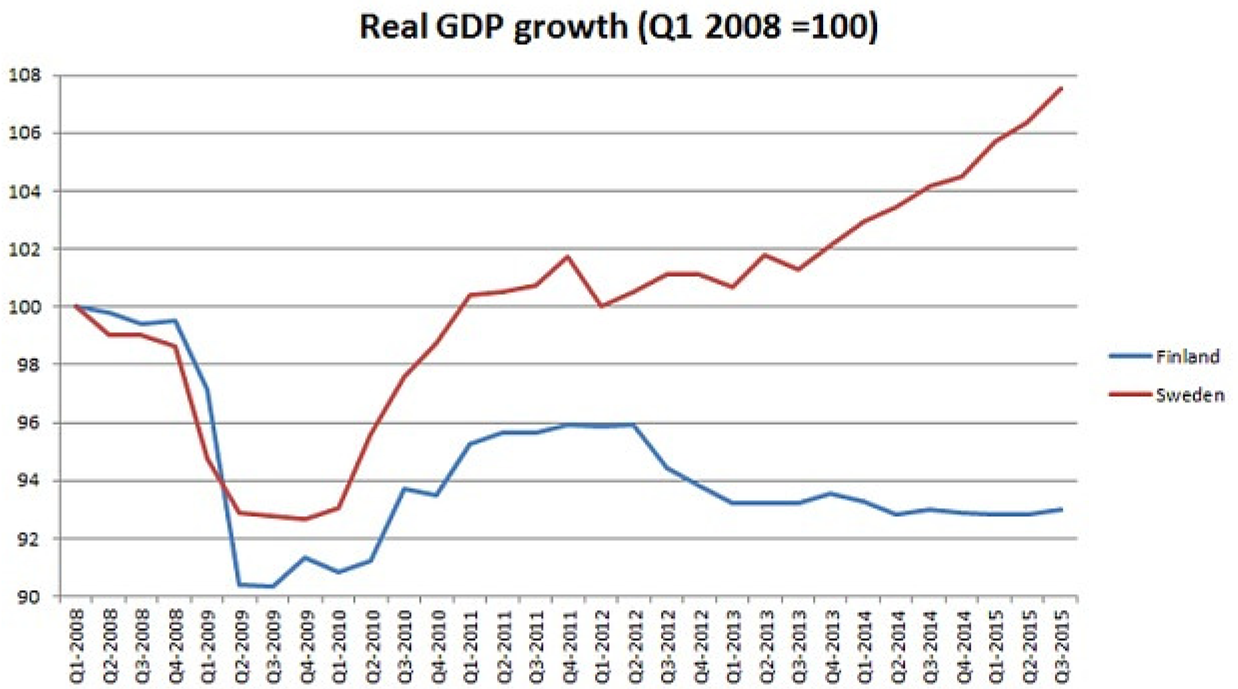
Its near-perfect profile demolishes the central claim of the German finance ministry - through its mouthpiece in Brussels - that countries get into bad trouble in EMU only if they drag their feet on reform and spend too much.

The country has obviously been hit by a series of asymmetric shocks: the collapse of its hi-tech champion Nokia, the slump in forestry and commodity prices, and the recession in Russia.

The relevant point is that it cannot now defend itself. Finland is trapped by a fixed exchange rate and by the fiscal straightjacket of the Stability Pact, a lawyers' construct that was never intended for such circumstances. The Pact is being enforced anyway because rules are rules and because leaders in the Teutonic bloc have an idee fixee that moral hazard will run rampant if any country in the EMU core sets a bad example.

Finland's output shrank a further 0.6pc in the third quarter and the country's three-year long recession is turning into a fourth year. Industrial orders fell 31pc in September. "It's spooky," said Pasi Sorjonen from Nordea.

Sweden was able to navigate similar shocks by letting its currency take the strain at key moments over the last decade. Swedish GDP is now 8pc above its pre-Lehman level.



The divergence between Finland and Sweden is staggering for two Nordic economies with so much in common, and it has rekindled Finland's dormant anti-euro movement.

The Finnish parliament is to hold 'Fixit' hearings next year on exit from monetary union and a return to the Markka, the currency that saved Finland in the early 1990s (once the ill-judged hard-Markka policy and the fixed ECU-peg was abandoned).

Paavo Väyrynen, a Euro-MP and honorary chairman of the ruling Centre party, forced the euro hearings onto the parliamentary agenda after collecting 50,000 signatures. "The eurozone is not an optimal currency area and people are becoming aware of the real reasons for our crisis," he said.

"We are in a similar situation to Italy and have lost a quarter of our industry. Our labour costs are too high," he said.

Voters in Sweden and Denmark stopped their governments abolishing their ancient currencies. Finnish voters were never given a referendum. The decision to join the euro was rammed through against widespread opposition, and was camouflaged as a national security issue.

Mr Väyrynen said the pro-euro camp whipped up the Russian threat in the 1990s, claiming that Finland needed to lock itself as deeply as possible into all aspects of the EU system for added security, (though not join Nato, the more relevant body) “They played the foreign policy card. It was a trick,” he said.

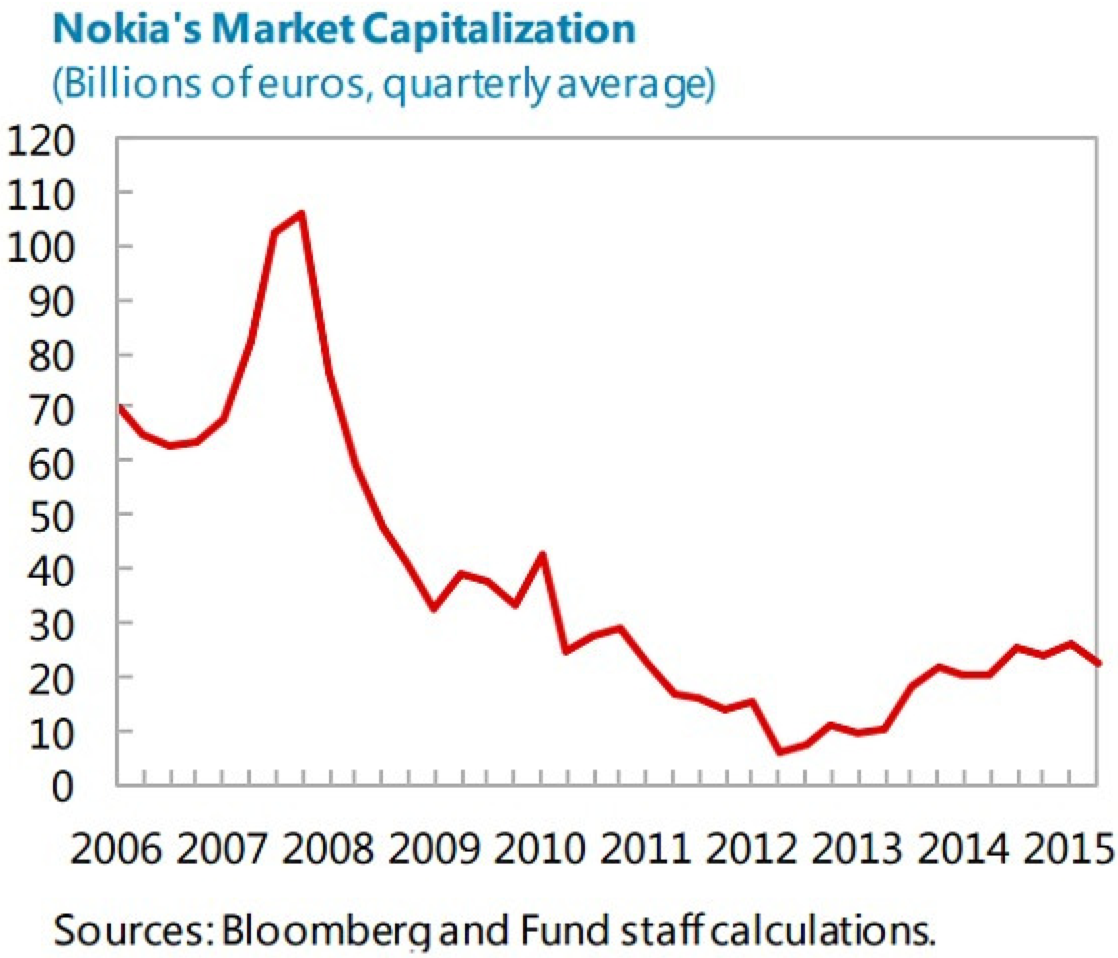
It is hard to avoid the conclusion that Finland handled its economic affairs with more skill in the 1920s and 1930s under the guiding hand of Risto Ryti (**much praised** by the Bank of England’s ex-Governor Lord King), who understood the evils of a misaligned exchange rate, and freed his country early from the ravages of the Gold Standard in 1931. He would never have been seduced by the easy promises of monetary union.

Ryti was an anti-Nazi anglophile. By a tragic sequence of events he found himself forced into alliance with Hitler against Stalin, and ultimately into war with Britain. It is arguably the only time in history that two developed democracies have come to serious blows.

The Bank of England tried to intercede at the end of the Second World War to prevent him being treated as a war criminal (as Stalin demanded), but failed. His sentence was hard labour. But I digress.

Finland's centre-Right coalition is determined to press ahead with an ‘internal devaluation’, the very policy that tipped half Europe into debt-deflation four years ago and caused debt ratios to rise even faster through the denominator effect. This is likely to be self-defeating for Finland as well, even on its own crude terms, given that household debt is over 100pc of GDP.

The government has failed to secure a social contract with the labour unions so it is now trying to circumvent this by chipping away at collective-bargaining powers – the latest example of how the euro system erodes workers’ rights and is fundamentally incompatible with the political values of the Left. The unions launched the biggest strikes for two decades in September.



It remains a mystery to me why the European Left continues to apologise for what can only be described as reactionary policies, but the mood is at last changing. Stefano Fassina, an Italian social-democrat and former deputy-finance minister, is leading a push for an "alliance of national liberation fronts" spanning Left and Right to overturn the EMU order.

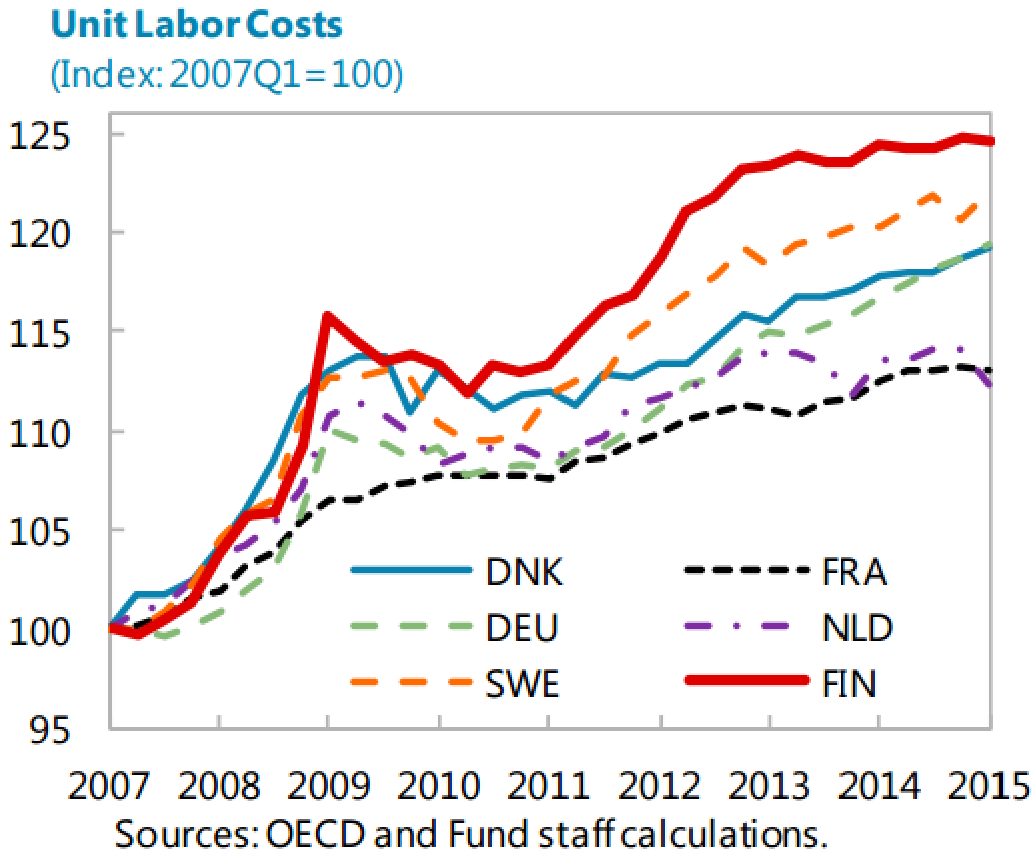
Mr Fassina, Germany's Oskar Lafontaine, France's Jean-Luc Melenchon, and Greece's Yanis Varoufakis, launched a branch of this front in Paris over the weekend, proposing a **'Plan B'** of parallel currencies and ultimately exit from the euro if EMU continues to enforce contractionary policies and operate outside democratic control - as they put it.

Finland is digging itself into an ever deeper hole. The International Monetary Fund **warned this week** against austerity overkill and “pro-cyclical” cuts before the economy is strong enough to take it.

The IMF spoke softly but the message was clear. Finland should not even be thinking of a “front-loaded” fiscal contraction or slashing investment at a time when its output gap is 3.2pc of GDP.

The Finnish authorities admitted in their reply to the IMF's Article IV report that they had no choice because they had to comply with the Stability Pact. This is what European policy-making has come to.

Some in Finland were quick to throw stones at Greece during the debt crisis, seemingly unaware at the time that they too lived in a glass house. Their own story is not really that different from the EMU disasters that unfolded in the South.



Interest rates were too low for Finland's needs during the commodity boom, causing the economy to overheat. Unit labour costs spiralled up 20pc from 2006 onwards, leaving the country high and dry when the music stopped. Public debt was low but private debt was high (somewhat like Spain and Ireland). The crisis hit later merely because the commodity bubble did not burst until 2012.

The 'Fixit' movement is a warning shot, as is the election of a triple-Left majority in Portugal vowing to tear up the austerity script - and still blocked from taking power on a constitutional pretext almost six weeks after the vote.

The eurozone may be enjoying a tentative recovery for now, thanks to the stimulus of a cheap euro, cheap oil, and quantitative easing, but it has wasted a full global economic cycle and is running out of time to restore its defences before the next global storm hits.

When the storm does hit, total public and private debt will be 270pc of GDP, 36 percentage points higher than it was just before the Lehman crisis in 2008. Society will already have suffered almost a decade of mass unemployment, and the poltical capital of the EMU elites will be almost exhausted.

The question has to be asked in any case: if the euro cannot be made to work for what is supposed to be the most competitive country in the EU, who can it work for?

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