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ASSESSING THE MACROECONOMIC IMPACT OF EU MEMBERSHIP FOR FINLAND

A REPORT ON BEHALF OF AKAVA

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Akava

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EXECUTIVE SUMMARY

Finland entered the European Union (EU) in 1995 as part of a trio of countries which increased the bloc's number to 15. The original decision to join was supported by a referendum and EU membership retained strong popular support in the following decade. However, since 2009, the political landscape has begun to shift with the Finns Party – standing on an anti-EU and anti-immigration platform – becoming the third largest party in parliament in 2011 and gaining further ground in 2015.

Since 2015 the political dynamic has shifted although it is important to note that the Finnish population, overall retains a favourable attitude towards EU membership.¹ In 2017, following a leadership contest, the Finns Party split into two. Neither party currently stands on a platform of leaving the EU with the emphasis instead on reforming the EU from the inside.

Although much rhetoric surrounds the debate, objective analysis of the economic impact of EU membership on Finland to-date is relatively thin on the ground. In this context, Akava has commissioned Oxford Economics to provide an independent review of existing evidence. The major findings of our research are described below with greater detail provided in the main body of the report.

WHAT HAVE BEEN THE MACROECONOMIC EFFECTS OF EU MEMBERSHIP FOR FINLAND?

Trade and FDI gains have supported living standards in Finland:

As part of its membership of the EU Finland has enjoyed the benefits of operating in a market with over half a billion consumers which has systematically reduced barriers to trade and investment between member states. This has **supported significant economic gains** as follows:

- The most direct estimates for Finland indicate that EU membership has lifted GDP per capita by between **1.2% - 1.7%** equivalent with an increase in average household income of between **€1,020 - €1,450** in 2017. This gain is broadly in line with the average for EU member states suggested by this research.
- We would expect this **gain to become larger in future** given recent initiatives such as the Energy Union, the Digital Single Market Strategy, the Capital Markets Union Action Plan and from new trade deals currently being negotiated by the Commission.
- There is less analysis on the overall impact of EU membership on jobs. However, a recent direct estimate for Finland suggested that the EU had helped to support an **extra 40,000 jobs** equivalent to **1.4 percent of the labour force in 2017**.
- Applying some of the most recent empirical evidence to the current structure of Finnish trade suggests that **EU membership has boosted**

¹ For example, according to a Eurobarometer survey in September 2018, 66 percent of Finns think that EU membership has been beneficial.

total trade by between **9% - 26%** - in 2017 this equated to between **€16 billion - €47 billion**.

- Membership of both the EU and EMU has supported greater inflows of inward investment. Applying some central estimates from the literature would imply that Finland has received an **extra €31.7 billion of inward FDI since 1995** due to its membership of the EU and EMU. This is the equivalent of an average annual effect **worth 0.9% of GDP during this period**.

The costs of EU membership are comparatively small:

Our analysis shows that the economic costs of membership are very small in comparison. The main factors are as follows:

- In 2017, Finland made a **total contribution of €1.6 billion to the EU budget**. However, considering EU expenditure in Finland its **net contribution** was just **€93 million or 0.04% of GDP**. Therefore, the **annual fiscal cost of membership is miniscule**.
- A previous study found that the **cost of EU regulations** for Finnish businesses was **equivalent to 0.4% of GDP**. However, we do not consider that this figure should be considered to represent a cost of membership – in most cases, **Finland would need to implement its own regulations in these areas even if it were operating outside of the EU**.

The macroeconomic impact of EMU has been broadly neutral:

In 1998 Finland opted to join Economic and Monetary Union (EMU) and adopted the Euro. If it were to leave the EU it would also have to leave EMU and revert to using its own national currency.

- Overall our review of the impact of EMU on Finland paints a much less decisive picture compared to EU membership with the evidence pointing to a **broadly neutral macroeconomic impact**.
- The one study which assessed the impact on Finland found that EMU had had a very positive impact on growth up to 2007. However, Finland's growth performance since 2008 suggests that this finding would not hold if the research was repeated using a more complete time series.

Overall, our review demonstrates that EU membership has driven widespread **economic benefits which are well in excess of the associated costs**.

Being part of the EU has helped **Finland's economy to further integrate into the global economy**, evidenced by higher levels of international trade and investment. This process has helped to drive productivity gains in the private sector which have supported higher earnings and living standards for Finnish citizens - our central estimate is that **average household income is between €1,040 and €1,450 higher due to EU membership**.

Moreover, it seems likely that **these benefits will continue to grow** as recent initiatives see the continued development of the Single Market. Such a trend implies that the cost of departure will continue to rise.

1. INTRODUCTION

CONTEXT AND OBJECTIVES

In common with the recent political experience of a number of other countries across the continent, the relative merits of Finland's membership of the European Union (EU) have become increasingly subject to scrutiny. Indeed, Finland's membership and adoption of the single currency both became key themes in the 2011 elections, with the Finns Party – who stood on an anti-EU and anti-immigration platform – becoming the third largest party in parliament.² Their popularity grew stronger during the Eurozone debt crisis and in 2015 they entered into a coalition government.³

Since 2015 the political dynamic has changed significantly. In 2017, following a leadership contest, the Finns Party split into two. Neither party currently stands on a platform of leaving the EU with the emphasis instead on reforming the EU from the inside.

A recurring complaint in the debate around the EU is the absence of facts about what it has achieved. In this context, this paper represents a timely contribution to the discourse, by providing an objective assessment of the macroeconomic impact of Finland's EU membership.

OUR APPROACH

As part of the research we have undertaken a detailed review of available evidence on the macroeconomic consequences of the EU. In addition to reviewing the results of available studies into the impact of EU membership on Finland specifically, we have augmented our review with studies which present results and findings for aggregate geographic areas – typically the EU15 or EU28. Restricting our literature review to Finland-specific studies would have meant that we would have drawn conclusions from an excessively narrow evidence-base. We have then applied the findings which we consider to be most relevant to Finland to develop quantitative estimates where possible.

The remainder of this paper applies this approach to discuss the macroeconomic implications of Finland's membership of the EU. It is structured as follows:

- Chapter two discusses the consequences of Finland's membership of the EU and assesses evidence on the macroeconomic impact;
- Chapter three describes Finland's experience as part of the Economic and Monetary Union (EMU) and discusses evidence on the economic benefits and costs; and
- Chapter four is a methodological appendix which presents tables summarising papers reviewed as part of this research.

² https://yle.fi/uutiset/osasto/news/finland_and_the_european_union_its_complicated/10197162

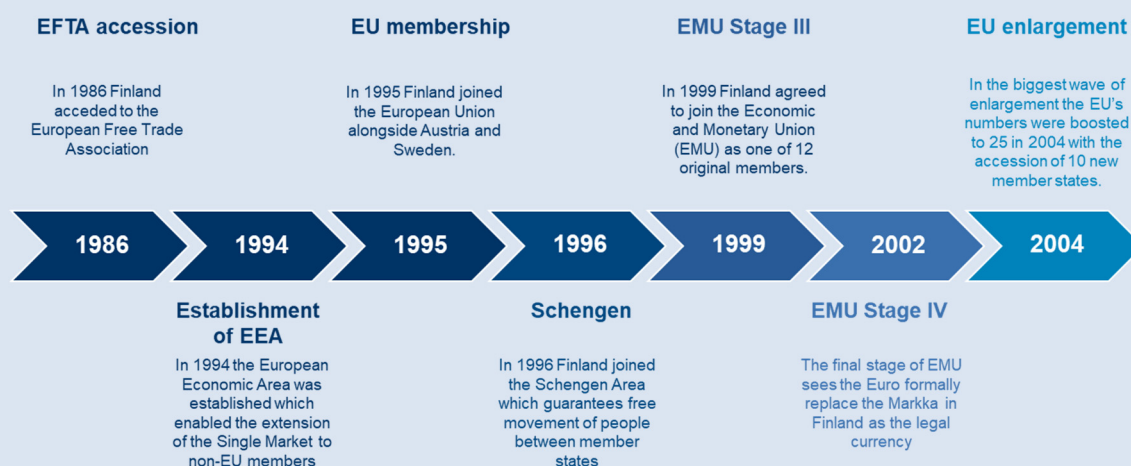
³ <https://www.reuters.com/article/us-finland-euroscptics/presidential-hopeful-wants-finland-out-of-eu-says-nationalists-will-bounce-back-idUSKBN1E722V>

FINLAND AND THE EU – A BRIEF HISTORY

Finland formally entered the EU in 1995 under the Treaty of Corfu signed the previous year. Its entry, alongside Sweden and Austria, brought the number of member states up to 15. Fig. 1 illustrates a timeline of major events since this point which are summarised in the bullet points below:

- **EFTA accession:** in 1986 Finland became a full member of the European Free Trade Association (EFTA)—it had been an associate member since 1961. The agreement allowed for the steady abolishment of internal tariffs on industrial but not agricultural products.
- **Establishment of the European Economic Area:** in 1994 the European Economic Area was established enabling non-EU members access into the Internal Market.
- **Schengen:** in 1996 Finland joined the Schengen Area which guarantees free movement of people between member states i.e. without border checks.
- **EMU Stage III:** in 1999 Finland agreed to join the Economic and Monetary Union (EMU) as one of 12 original members.
- **EMU Stage IV:** the final stage of EMU sees the Euro formally replace the Markka in Finland as the legal currency
- **EU enlargement:** in the biggest wave of enlargement the EU's numbers were boosted to 25 in 2004 with the accession of 10 new member states.

Fig. 1. Timeline of key events



2. THE MACROECONOMIC IMPACT OF EU MEMBERSHIP

WHAT DOES IT ENTAIL?

At the core of the EU project, and formally enshrined in the Treaty of Rome, is the ambition to establish a Single Market across member states. This goal has been supported by a series of policies governing the movement of goods, services, capital and people – the so-called ‘four freedoms’.

The economic consequences of these policies have been far-reaching. The most significant elements of EU membership for Finland’s economy include:

- Finland participates within the EU’s customs union.⁴ This ensures that products traded between member states are free from tariffs and border checks.⁵ It is also the link for member states into the World Trade Organisation (WTO).
- The EU has agreed and ratified preferential trade agreements with a further 34 countries.⁶ Over three-quarters of Finland’s international trade is with other members of the EU or these other countries.
- Finland’s domestic regulatory structure has been influenced by a string of reforms and legislation initiated by the European Commission which seek to reduce advantages enjoyed by domestic firms and promote competition between firms operating across member states.
- As part of EU membership Finland operates by the principle of free movement of workers. This ensures all EU citizens the same employment legal rights as locals whilst also providing right of residence to direct family members.
- Finland makes an annual contribution to the EU budget which covers expenditure on items such as agricultural subsidies, Research and Development (R&D) and regional development assistance.

WHAT WAS THE EXPECTED IMPACT ON TRADE, FDI AND LIVING STANDARDS?

As described, the overarching economic objective of the EU has been to create a Single Market between member states which eliminates as far as possible barriers to trade and investment. Moreover, by facilitating increased levels of trade and FDI between member states it was expected that the EU could act as a catalyst to drive higher rates of growth and an overall increase in living standards.

80%

Share of Finland's trade covered by preferential deals

Trade within the EU and with countries with which the EC has struck a preferential deal covered 80% of Finland's total trade in 2017.

⁴ The customs union currently consists of the 28 EU member states and Monaco. In addition, Andorra, San Marino and Turkey form part of the customs union via separate bilateral agreements.

⁵ In addition, members of the customs union apply a uniform tax (the Common External Tariff) on imports from countries with which the EU does not have a preferential deal.

⁶ This figure refers to the number of trade agreements which have been formally ratified and are in force. However, a large number of deals have been provisionally applied but are not in force with other agreements still in the negotiation phase. Therefore, this figure is likely to increase significantly over time.

There is strong evidence that international trade – both exports and imports – helps to boost productivity. Such productivity gains come through a number of channels as follows:

- it helps countries to specialise in activities in which they are relatively more efficient encouraging a superior allocation of resources;
- as firms can grow their revenues by accessing a larger market they benefit from economies of scale;
- it promotes competition between a wider pool of firms which should help to drive down prices and improve quality standards; and
- it encourages the exchange of ideas between people and businesses which should help to spur innovation.

Similarly, it has been demonstrated that FDI can also act as a driver of higher productivity and growth in the long-term. Businesses which invest abroad help to spread innovation and best-practice production techniques across businesses in the home nation boosting productivity.

Prior to implementation, studies attempted to quantitatively assess how the creation of a Single Market would affect the economic performance of member states. The most prominent among these was the Cecchini Report⁷ which estimated that real GDP per capita could be lifted by between 4.25% - 6.5% in the medium term.⁸ Subsequently, Baldwin (1989) estimated that a wider set of benefits not modelled in the Cecchini Report would approximately double these gains.⁹

Up to 2007, the public perception of the economic effects of the EU was largely positive. However, this position has been challenged since the Global Financial Crisis (GFC) with Finland suffering from a prolonged recession between 2012 and 2014 perpetuated by the Eurozone debt crisis. Criticism has centred on Finland's membership of the EMU and the level of financial support that was provided to countries which endured fiscal crises following the GFC.

In this next section we investigate to what extent these potential gains have been realised in Finland with a focus on trade, FDI and GDP per capita.

HAS THIS BEEN BORNE OUT?

There is little doubt that Finland's membership of the EU has boosted trade

Empirical evidence suggests that membership of the EU has helped to drive materially higher levels of trade between Finland and other member states. As described above, at the heart of the Single Market programme has been a goal to steadily reduce barriers to trade between member states. Overall, evidence reviewed as part of this research suggest that this process has been

⁷ P, Catinat, M and Jacquemin, P Cecchini, "Europe 1992: The Overall Challenge" (Report for the European Commission, 1988).

⁸ It is worth noting that these figures are for the 12 founding members and did not consider Finland.

⁹ R Baldwin, "On the Growth Effects of 1992" (NBER Working Paper, 1989).

successful.¹⁰ The bullet points below summarise the findings from this research:

- Straatof et al (2008) find that for the cohort of countries which joined in 1995 – which includes Finland – the Single Market has raised trade in goods with other member states by 18% and trade in services with other member states by 5%;¹¹
- Van der Marel and Shepherd (2013) find that the EU has boosted the value of international trade in services by 65% and that its impact has been much greater than other regional trade agreements;¹²
- In a similar exercise Ceglowski (2006) found that the EU had boosted services trade by a smaller but still significant 26%;¹³
- Huffbauer and Schott (2007) find that the EU has increased goods trade between member states by 31%; and
- CER (2014) found that UK-EU trade was 55% higher than predicted by other factors which they attribute to EU membership.¹⁴

Overall this type of approach has consistently found that the EU has significantly boosted trade between member states. The scale of this impact is somewhat uncertain as signalled by a relatively wide range of estimates. We consider that the Straathof et al study provides evidence which is most directly applicable to Finland since it provides a direct estimate for the three countries which joined in 1995 (Finland, Austria and Sweden). However, it is likely to be conservative since it provides estimates for the impact up to 2005 and therefore excludes the impact of subsequent reforms which have sought to further facilitate trade such as the Services Directive and the Single Market Act.

A number of studies have recently investigated the implications of the UK leaving the EU on international trade in light of the vote to leave. This effect is likely to depend critically on the type of trading relationship which the UK is assumed to agree with the EU (and potentially other trading partners) after exit. In our view, estimates which assume that the UK will revert to the least preferential Most Favoured Nation (MFN) terms provide the best proxy of the overall contribution of EU membership to trade. The key findings from two of the most prominent studies are summarised in the bullet points below:

- The Treasury's latest economic analysis suggested that a managed no deal scenario would result in exports to the EU falling by 35% and imports from the EU by 39% in the long-term¹⁵; and

9% - 26%

Estimated range of increase in trade in Finland due to EU membership

Applying some of the most relevant insights from the literature we estimate that EU membership increased the value of trade in Finland in 2018 by between €17.0 billion and €49.4 billion.

¹⁰ Several major studies have investigated the role of the EU in influencing the scale and geographic composition of international trade using a gravity modelling approach. By examining historical patterns of trade between countries the aim is to isolate the marginal impact of the EU for its members controlling for other factors.

¹¹ B, Linders, G, Lejour, A and Mohlmann, J Straathof, "The Internal Market and the Dutch Economy" (CPB Document no. 168, 2008).

¹² Erik van der Marel and Ben Shepherd, *Services Trade, Regulation and Regional Integration: Evidence from Sectoral Data* ([n.p]: The World Economy, 2013).

¹³ J Ceglowski, "Does Gravity Matter in a Service Economy?", *Review of World Economics*, Vol 142 (2) (2006): 307-29.

¹⁴ Centre for European Reform, "The economic consequences of leaving the EU: The final report of the CER Commission on the UK and the EU single market" (Research report, 2014).

¹⁵ Her Majesty's Treasury, "EU Exit: long-term economic analysis" (unpublished thesis, 2018).

- Dhingra et al (2016) presented both an optimistic and a pessimistic case. In the former, imports to the EU fall by 25% and exports to the EU by 22% with these figures rising to 44% and 38% in the latter.¹⁶

Table 1 applies these sets of results to Finland's current structure of international trade. Using the Straathof results, which we think are likely to be conservative, implies that EU membership increased Finland's value of international trade by 9.1% in 2018 or €17.0 billion. On the other hand, application of results from recent Brexit studies imply an overall impact between 13% - 26% or €24.2 billion - €49.4 billion.

Benchmarking these studies against the actual pattern of observed trade in Finland during this period is also useful in this context. Overall, the value of trade increased by €118.0 billion between 1995 – 2018 so these findings would suggest that the Single Market has been responsible for between 15% - 44% of this observed growth.

Table 1: Application of empirical estimates of the relationship between EU membership and trade to Finland¹⁷

	Exports		Imports		Trade	
Author	% change	€ billions	% change	€ billions	% change	€ billions
Straathof et al	8.2%	7.4	10.0%	9.6	9.1%	17.0
HMT	17.0%	15.4	26.1%	25.0	21.6%	40.4
Dhingra et al (optimistic)	9.7%	8.8	16.1%	15.4	13.0%	24.2
Dhingra et al (pessimistic)	21.4%	19.3	31.3%	30.1	26.4%	49.4

Source: Oxford Economics calculations, Eurostat, OECD

Likewise, EU membership has helped Finland to attract considerable additional inflows of FDI

The bulk of the empirical evidence that we have reviewed suggests that the EU has been successful in helping to stimulate investment between member states with no evidence of displacement effects. Findings from some of the major studies reviewed are:

¹⁶ S, Huang, H, Ottaviano, G, Paulo Pessoa, J, Sampson, T and Van Reenen, J Dhingra, "The Costs and Benefits of Leaving the EU: trade effects" (CEP Discussion Paper no 1478, Centre for Economic Performance, 2016).

¹⁷ It is worth noting that the proportionate impacts in the table for the Brexit-related scenarios do not correspond to those quoted in the bullet point text above. This is because the reported estimates relate to intra-EU trade – we have used the geographic structure of Finland's trade in 2017 to develop equivalent effects for total trade.

- Bruno et al (2016) find that EU membership has boosted inflows of FDI by between 14% - 38% depending on the precise specifications of their model – they report an average effect of 28% which they consider their baseline case;¹⁸
- Straathof et al (2008) find that the internal market has supported an average increase of 16% in the stock of inward FDI across the EU15;¹⁹
- Flam and Nordstrom (2008) find that the Single Market has had a very significant impact on FDI increasing internal cross-border flows by 85% and flows with non-members by 45%;²⁰
- Hufbauer and Schott (2007) estimated that EU membership had increased FDI inflows from non-member states by 27% on average;²¹ and
- Clausing and Dorobantu (2005) found that the announcement of EU accession helped to boost inflows of FDI for the 2004 cohort by 51%.

Overall, we consider that the Bruno et al study is likely to offer the most reliable guide to the scale of the benefits of EU membership via increased inward investment. It uses more advanced econometric techniques which help to isolate the marginal impact of the single market and covers a more up-to-date sample period. Applying their baseline estimate that EU membership has increased inward FDI by 28% implies that Finland has received an additional €31.7 billion since 1995.

Table 2: Overview of findings from studies assessing the relationship between EU membership and FDI

Author	Sample period	Measure	Impact of EU membership
Bruno et al	1985 - 2013	Total inward FDI flows	28%
Straathof et al	1981 - 2005	Total inward FDI stock	16%
Flam, H and Nordstrom, H	1995 - 2005	Inward FDI flows	85% intra-member, 45% extra-member
Clausing, K and Dorobantu, C	1992 - 2001	Total inward FDI flows	51%
Hufbauer, G and Schott, J	1976 - 2005	Intra-EU FDI stock	27%

Increased trade and FDI have helped to boost productivity and enhance living standards for Finnish households

As described in the previous section, both trade and FDI have been shown to support higher productivity helping firms to produce more output with the same inputs. Consequently, higher productivity is the driver of improvements in living standards as measured by GDP per capita. Studies which have assessed the

¹⁸ Randolph Bruno et al., *Gravitating Towards Europe: An Econometric Analysis of the FDI Effects of EU Membership* ([n.p]: Centre for Economic Performance, 2016).

¹⁹ B, Linders, G, Lejour, A and Mohlmann, J Straathof, "The Internal Market and the Dutch Economy" (CPB Document no. 168, 2008).

²⁰ H and Nordstrom, H Flam, "The Euro and Single Market impact on trade and FDI" (Research report, 2008).

²¹ Gary Clyde Hufbauer and Jeffrey Schott, "Fitting Asia-Pacific Agreements into the WTO System" (Report presented at the Joint Conference of the Japan Economic Foundation and Peterson Institute for International Economics on "New Asia-Pacific Trade Initiatives", Peterson Institute for International Economics, 2007), 63.

1.2%-1.7%

Estimated increase in real GDP per capita in Finland

The most applicable recent studies point to EU membership supporting an increase in GDP per capita of between 1.2%-1.7% which would translate into an average income gain of between €1,020 and €1,450 per household in 2017.

link between EU membership and GDP per capita appear to bear out this relationship as follows:

- A recent study by LE Europe estimated that real GDP per capita in Finland was 1.7% higher due to Single Market reforms implemented since 1990, in line with the EU average²²;
- Ilzkowitz et al (2010) found that GDP per capita in the EU15 was 2.1% higher as a result of Single Market reforms between 1992 – 2006;²³ and
- Peterson et al (2014) found that GDP per capita in Finland was 1.2% higher as a result of EU membership in 2012.

The two direct estimates for Finland imply a gain of between 1.2% and 1.7%. Applying this to the level of GDP per capita and adjusting for average household size implies that EU membership raised average household incomes by between €1,020 and €1,450 compared to what it otherwise would have been in 2017.

OTHER EFFECTS

EU membership has had a positive impact on the labour market with a net positive impact on jobs

We have not been able to identify much empirical analysis on the overall impact of EU membership on jobs. However, a recent direct estimate for Finland suggested that the EU had helped to support an extra 40,000 jobs equivalent to 1.4 percent of the labour force in 2017.²⁴

The most direct channel through which EU membership has affected the labour market is via free movement of people. Finland has been a regular net recipient of EU migrants with net inward migration averaging 15,615 per year between 2008 and 2017.²⁵ Although we have not been able to access formal data it is likely that many of these individuals are of working-age and will participate in the labour market. For example, data from Statistics Finland showed that over 80 percent of the total migrant stock in Finland in 2017 were aged 15-64.²⁶ It is impossible to know how the Finnish government would have chosen to regulate the inward flow of migrants from the EU if it were outside the free market. However, it is plausible that the policy of free movement has led to a higher level of net migration than would otherwise have been the case.

Our review of the literature on the economic effects of migration suggests the following:

²² LE Europe, "The EU Single Market: Impact on Member States" (Research Report, 2017).

²³ F, Dierx, A, Kovacs, V and Sousa, N Ilzkowitz, "Steps towards a deeper economic integration: the internal market in the 21st Century "(Economic papers, EC, 2010).

²⁴ LE Europe, "The EU Single Market: Impact on Member States" (Research Report, 2017).

²⁵ "Database", in Eurostat <<https://ec.europa.eu/eurostat/data/database>> [accessed 23 January 2019]

²⁶ https://www.stat.fi/tup/maahanmuutto/maahanmuuttajat-vaestossa/ulkomailla-syntyneet_en.html#tab1483972266178_2

0.1%

Net contribution to EU budget in 2017 as a share of government expenditure

Finland's net contribution to the EU budget in 2017 was €94 million. This was the equivalent of less than 0.1% of government spending in that calendar year.

- Given the age profile of Finnish migrants it is highly likely that they make a positive fiscal contribution. This is supported by recent findings by the Migration Advisory Committee in the UK.²⁷
- Higher rates of migration do not affect the employment rate of existing residents. There is no fixed supply of jobs in the economy and whilst the arrival of new migrants increases the supply of labour it also creates new job opportunities.
- There is some evidence that higher rates of migration help to support productivity growth, but the impact has generally been found to be relatively small.²⁸

Overall our review indicates that EU membership has had a positive impact on Finland's labour market. The evidence suggests that EU membership has had a positive impact on job creation. Moreover, the fact that EU membership has helped to drive stronger productivity growth in Finland will have had a positive impact on the real earnings of employees. The EU's policy of free movement is likely to have encouraged an increased inflow of economic migrants to Finland. The balance of evidence suggests that this increased migration will not have had a significant impact on existing residents' earnings or employment rates and will have made a positive fiscal contribution helping to support higher levels of government expenditure and/or lower rates of taxation.

The fiscal cost of EU membership to Finland is minimal

In 2017, Finland made a total contribution of €1.6 billion to the EU budget equivalent to 0.7% of GDP or 1.3% of total government expenditure in that year. However, total EU spending in Finland in 2017 amounted to €1.5 billion meaning that the country's net contribution was just €94 million equivalent to less than 0.1% of total government spending in that calendar year. Therefore, the cost of membership, in this context, is very small.

Complying with EU regulations does bring costs to business but there is no guarantee these would have been lower if left to Finnish policymakers

Another key area that is often cited by Eurosceptics is the bureaucratic burden placed on domestic businesses due to being forced to comply with Single Market regulations. Eurochambres (2009) use available national impact assessments and apply the results to missing countries to assess the cost of EU regulations to businesses between 1998 – 2008. They found a total cost to Finnish businesses during this period of €6.5 billion equivalent to 0.4% of GDP.²⁹

However, it is important to note that this figure should be equated with the cost of EU membership. In general, it is not realistic to assume that Finland would not have implemented any regulations governing these areas had they not been a member of the EU. Indeed, OECD measures suggest that regulatory complexity in Finland is broadly similar to the EU28 average and somewhat behind the EU frontier (as indicated by the least regulated economy in the

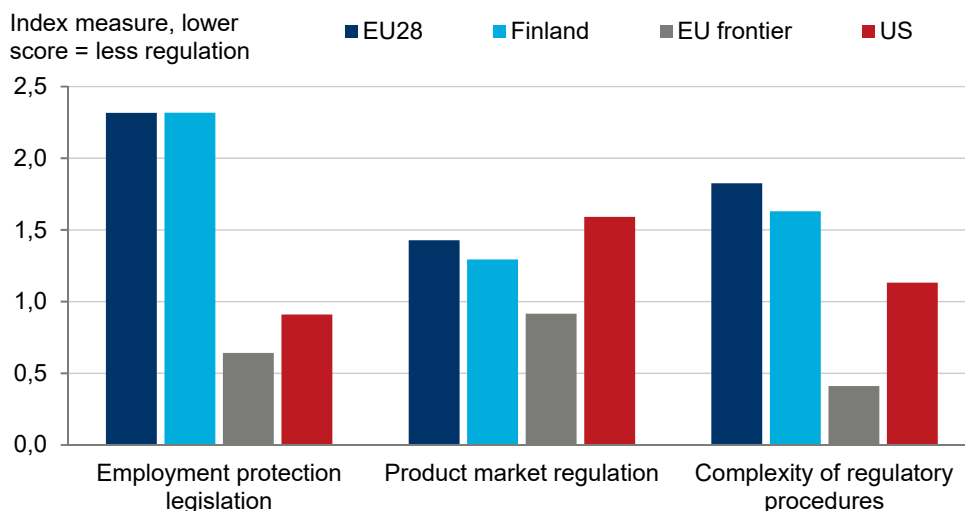
²⁷ "The Fiscal Impact of Immigration on the UK" (A report for the MAC by Oxford Economics, June 2018).

²⁸ Migration Advisory Committee, "EEA Migration in the UK: Final report" (Research report, 2018).

²⁹ Eurochambres, "Counting the Cost of EU Regulations to Businesses" (Research report, 2009).

bloc). As a crude approximation this suggests that Finland's policy sovereignty has not been unduly constrained in this area – there are economies in the EU which operate with a more 'light touch' regime reflecting their own policy choices.

Fig. 2. Overview of regulatory burden in Finland in EU context



Source: OECD, Oxford Economics calculations

CONCLUSION

Our appraisal demonstrates that EU membership has had a positive and significant macroeconomic impact on Finland

Overall our review of the evidence suggests that membership of the EU has had a positive macroeconomic impact on Finland. Being a part of the Single Market has led to very significant increases in the level of trade and inward investment than otherwise would have occurred. Our central estimates imply that contribution of EU membership has been to raise total trade by between 9% and 26% and FDI by 28%.

This in turn has helped to drive improvements in productivity and hence living standards. Our review suggests that the impact is that EU membership has increased GDP per capita by between 1.2% and 1.7%. This is a less material gain than was predicted prior to the formation of the EU but is nonetheless significant. In 2017, this effect would have been sufficient to raise the average level of household income in Finland by between €1,020 and €1,450.

Set against this, the annual fiscal cost of membership is miniscule. On a net basis (total contribution less money spent from the EU budget spent in Finland) it amounted to just 0.04% of GDP in 2017. As part of membership Finnish businesses are forced to comply with a set of regulations which are designed to ensure a level playing field between businesses operating in different countries and to lower barriers to trade and investment. The cost of EU regulations in Finland was estimated to amount to 0.4% of GDP between 1998 and 2008.

3. THE MACROECONOMIC IMPACT OF EMU

In 1999 Finland became one of the founding members of EMU. As part of this is has adopted the Euro as its national currency, a process that was formally completed in 2002. If Finland were to leave the EU it would also abandon the Euro. Therefore, in this section we investigate the macroeconomic impact of EMU membership on Finland in a similar style to the previous chapter.

WHAT DOES IT ENTAIL?

The most obvious consequence of entering EMU is that Finland stopped using the Markka with Euro notes and coins becoming the sole form of legal tender. However, being part of a currency union has meant that Finland has given up control of a number of different tools of economic policy:

- It has handed over responsibility for monetary policy (the setting of interest rates and control of the money supply) to the European Central Bank (ECB).
- As part of EMU, Finland is required to comply with a set of rules which govern the scale of government borrowing, technically constraining its capacity to use fiscal policy to support the economy during a downturn. These are collectively known as the Stability and Growth Pact (SGP).

WHAT WERE THE EXPECTED ECONOMIC CONSEQUENCES?

It was expected that EMU would represent a further important plank in developing a genuinely Single Market. Exchange rate movements create natural uncertainty for businesses seeking to engage in trade and investment. By eliminating this source of risk, it was expected that trade and investment between member states would be boosted which in turn would support improved productivity and living standards through the channels outlined in the previous chapter.

However, as described, being a member of a currency union also involves giving up control of some of the major levers of macroeconomic policy. A large body of work in the economics literature has assessed what in theory should determine the value of this trade-off.³⁰ A full discussion of this theoretical framework is beyond the scope of this paper. However, it is worth noting that for the purposes of this research we have used evidence on Finland's growth performance since 1999 to evaluate this trade-off.

³⁰ R Mundell, "The Theory of Optimal Currency Areas", *American Economic Association*, 51 (4) (1963): 657-65.

WHAT HAS HAPPENED?

The Single Currency has increased trade between member states, but the gains seem more marginal compared to the benefits from the Single Market, trade policy and other economic activities of the EU

As documented in Rose (2016), the majority of results from the empirical literature have pointed to EMU having a marginal positive trade-enhancing effect between member states.³¹ He collects findings from 45 studies which show a median impact of 7.3%. There is a relatively wide range of estimates with one-in-six of these studies identifying a much more significant impact in excess of 20%. Alongside methodological differences this uncertainty reflects the difficulty of disentangling the effects of EMU from the wider impact of the Single Market project.

Based on our review we think that the balance of evidence points towards EMU having had a marginal positive impact on international trade which is likely to have been focused between member states. However, given the uncertainty – approximately 30% found a relationship which was either negative or statistically insignificant – we have not assumed that Finland has received any additional trade boost from membership of EMU. One reason for the lack of a strong link between EMU and trade may be that firms have predominantly used EMU as a platform to use FDI as a substitute for trade.³² In the next section we address the evidence related to the FDI impacts of EMU.

The Euro has boosted cross border flows of investment

Following the implementation of EMU, a number of studies have attempted to estimate the impact of the Euro on FDI for members as summarised in Table 3. In general, these studies have found that EMU has had a positive impact on FDI flows between members, with just one of seven studies reviewed finding no significant relationship.

Table 3: Overview of findings from studies assessing the relationship between EMU and FDI

Author	Sample period	Measure	Impact of EMU
Abbott, A and De Vita, G	1980 - 2003	Total inward FDI	25% - 30%
Stojkov, A and Warin, T	1995 - 2015	Intra-EU FDI flows	18.30%
Aristotelous, K and Stillianos, F	1973 - 2006	Total inward FDI	11.7% - 22.9%
De Souse, J and Lochard, J	1992 - 2005	Intra-EMU FDI stock	29%
Petroulas, P	1992 - 2001	Intra-EU FDI flows	17%
Flam, H and Nordstrom, H	1999 - 2006	Intra-EU FDI flows	No impact
Brouwer et al	1992 - 2001	Total inward FDI	27%

³¹ A Rose, "Why Do Estimates of the EMU Effect on Trade Vary so Much?" (Research report, Haas School of Business, Berkeley CA, 2016).

³² J, Doms, A, Gorin, Y, Guillet, X and Morchoisne, D Fournier, "Implicit Regulatory Barriers in the EU Single Market: New Empirical Evidence from Gravity Models" (OECD Economics Working Paper non 1181, 2015).

On the other hand, Taylor (2008) provided some descriptive analysis which highlighted that estimates which focused on the early implementation period may have been distorted by using a sample period which involved a global M&A boom.³³ This is consistent with the findings of Stojkov and Warin who find that the estimated impact is lower in the post-crisis period.

Overall, we find that, on balance, the empirical evidence from the literature points towards the impact of EMU being positive for FDI. We consider that the Stojkov and Warin study offers the best guide to the overall effect on Finland given the longer sample period. It is also broadly in the middle of estimates identified in our review. Applying the result to cumulative inflows of intra-EMU FDI since 1999 implies that membership of EMU has helped to boost inward investment by €7.6 billion.

Despite these benefits, membership of EMU seems to have had little discernible impact on growth and living standards

Evidence on the net impact of EMU on countries' GDP per head is mixed with no consensus apparent in our review of the literature. One means to assess the net impact of EMU is to compare economic performance in benchmark countries' who did and did not adopt the Euro. The key findings from studies which have done this are summarised below:

- Fernandez et al (2015) find that GDP per capita in the Euro Area was 0.7% lower in 2007 as a result of EMU but found that Finland was an outlier with real GDP per head found to be 10.5% higher in 2007 as a result of EMU;³⁴
- Solderstrom (2008) found that Swedish real GDP would have been 0.3% higher in 2007 if it had joined EMU but that growth would have also been more volatile;³⁵
- In contrast, Gyoerk (2017) estimates that productivity in Sweden would have been 10% lower in 2015 if it had joined EMU rather than opting out;³⁶ and
- Holland and Liadze (2008) find that EMU increased the level of real GDP in five member states (Belgium, Germany, France, Italy and the Netherlands) by 2.1% on average by 2006.³⁷

The evidence from this line of inquiry is mixed with a broadly even balance between the number of economies where GDP per capita was found to have been higher due to membership of EMU and those where the impact was found to have been negative.

³³ C Taylor, "Foreign Direct Investment and the Euro: The First Five Years", *Cambridge Journal of Economics*, 32(1) (2008): 1-28.

³⁴ C and Garcia Perea, P Fernandex, "The Impact of the Euro on Euro Area GDP per Capita" (Bank of Spain Research Report, 2015).

³⁵ U Soderstrom, "Re-Evaluating Swedish Membership in EMU: Evidence from an Estimated Model" (Swedish Bank Working Paper Series 227, 2008).

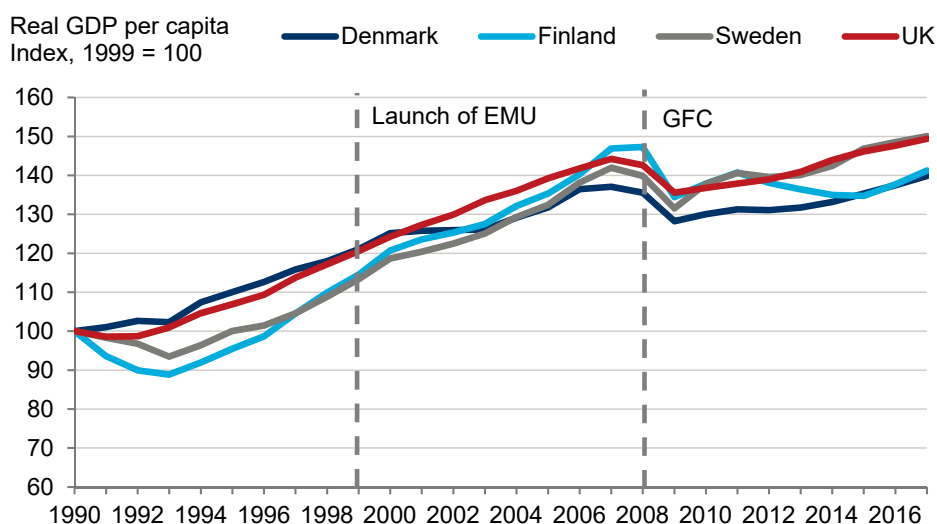
³⁶ E Gyoerk, "Economic Costs and Benefits of EMU Membership from the Perspective of a Non-member", *Open Economic Review*, 28 (2017): 893-921.

³⁷ D and Liadze, I Holland, "The Impact of EMU on Growth in Europe" (NIESR research paper, 2008).

Overall, it appears that the results are sensitive to the control group and sample period. Fig. 3 compares the path of real GDP per capita in Finland and three other high-income EU economies which opted out of EMU: Denmark; Sweden; and the UK. In the period between 1999 and 2007 Finland's real GDP per capita grew significantly faster than any of this peer group of countries (and a number of other high-income economies not displayed here).

However, since 2008 this pattern has reversed sharply. Weighed down by the Eurozone debt crisis, Finland's economy contracted for three consecutive years between 2012 and 2014, whilst Denmark, Sweden and the UK enjoyed steady if unspectacular growth. This suggests that this type of approach would not imply that Finland has received a significant benefit from EMU membership if it was run using a time series which includes activity since the financial crisis.

Fig. 3. Path of real GDP per capita in Sweden compared to other economies since 1990



Source: Oxford Economics

EMU membership has not imposed undue constraints on fiscal policy

As part of its membership of EMU Finland is required to comply with procedures which could affect its capacity to use fiscal policy to support the economy during a downturn. As part of its membership of the Single Currency Finland abides by the rules of the Stability and Growth Pact (SGP) which places technical limits on the scale of government borrowing. For the most part Finland has operated a conservative fiscal policy with annual borrowing and the overall stock of government debt lying comfortably within the statutory limits of 3% and 60% of GDP respectively. This suggests that the overall impact of the SGP in terms of constraining fiscal policy independence has been fairly limited.

CONCLUSION

Membership of EMU has had a broadly neutral macroeconomic impact

Overall our review of the impact of EMU on Finland paints a much less decisive picture compared to EU membership. The balance of evidence suggests that

EMU has helped to increase trade and FDI, particularly between member states, with these gains likely to have been proportionately larger for the latter.

However, despite these effects, studies that have assessed the growth impact of EMU provide a very mixed set of results with a broadly even split between positive and negative estimates. The one study which assessed the impact on Finland found that EMU had had a very positive impact on growth up to 2007. However, Finland's growth performance since 2008 compared to other high-income European economies suggests that this finding would not hold if it was repeated using more recent data.

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METHODOLOGICAL APPENDIX – SUMMARY OF STUDIES REVIEWED

Table 4: Overview of studies which have assessed the impact of the EU on GDP per capita

Author	Year	Title	Time frame	Approach	Ex ante or Ex post?	Result geography	Impact on GDP per capita
LE Europe	2017	The EU Single Market: Impact on Member States	1990 - 2015	This study uses an econometric model to estimate the impact of the Single market for all member states individually (except Malta and Luxembourg) and collectively.	Ex post	Finland	1.7%
European Commission	2010	Steps towards a deeper economic integration: the Internal Market in the 21st century	1992 - 2006	Runs simulations in a general equilibrium model to test the impact of the Single Market Programme on member states' GDP and employment.	Ex post	EU15	2.1%
Peterson et al	2014	20 years of the European single market: growth effects of EU integration	1992 - 2012	Regression analysis to establish the relationship between economic integration and real GDP growth. Results for individual member states then calculated by applying an index measure of integration for each economy.	Ex post	Finland	1.2%
Bolto and Eichengreen	2008	The Economic Impact of European Integration	1992 - 2008	Econometric analysis seeking to establish the independent impact of EU membership on economic growth controlling for other factors.	Ex post	EU25	5.0%
European Commission	1996	The impact and effectiveness of the Single Market	1990 - 1994		Ex post	EU12	1.1% - 1.5%
Cecchini et al	1988	The Benefits of a Single Market	5-6 years after completion	Estimates the gains from the establishment of a Single Market as a result of the elimination of all trade and production barriers, economies of scale and enhanced competition	Ex ante	EU12	4.25% - 6.5%

Table 5: Overview of studies which have assessed the impact of EMU on GDP per capita

Author	Title	Country	Results	Method	Impact on real GDP per capita (%)
Gyoerk, E	Economic Costs and Benefits of EMU Membership from the Perspective of a Non-member	Sweden	Productivity would have been 10% lower within monetary union	Synthetic control method	-10.00%
Gomis-Porqueras, P and Puzello, L	Winners and Losers from the Euro	Belgium	Real GDP per capita 7.7% lower due to Euro adoption	Synthetic control method	-7.70%

		France	Real GDP per capita 13.7% lower due to Euro adoption	Synthetic control method	-13.70%
		Italy	Real GDP per capita 17.3% lower due to Euro adoption	Synthetic control method	-17.30%
		Germany	Real GDP per capita 13.2% lower due to Euro adoption	Synthetic control method	-13.20%
		Netherlands	Real GDP per capita 2.5% higher due to Euro adoption*	Synthetic control method	2.50%
		Ireland	Real GDP per capita 23.7% higher due to Euro adoption	Synthetic control method	23.70%
Peseran, H and Vanessa Smith, L	What if the UK or Sweden had Joined the Euro in 1999? An Empirical Evaluation using Global VAR	UK	UK real GDP 0.5% lower after five years as a result of not adopting the Euro	Counterfactual simulation on a macroeconomic model	0.50%
		Sweden			
Solderstrom, U	Re-evaluating Swedish Membership in EMU: Evidence from an Estimated Model	Sweden	Swedish real GDP growth would have been 0.05 percentage points higher on average but also more volatile	Counterfactual simulation on a macroeconomic model	0.30%
Fernandez, C and Garcia Perea, P	The impact of the Euro on Euro Area GDP per capita	Euro Area	Euro Area real GDP per capita boosted in the early adoption period (1999 - 2003) but this was fully wiped out by 2007.	Synthetic control method	-0.70%
		Finland	Very significant gains in the early adoption period sustained through to 2007		10.50%
Holland, D and Liadze, I	The impact of EMU on growth in Europe	Five members including Belgium, Germany, France, Italy and the Netherlands	Found that EMU had made a small positive impact on real GDP on supply side output	Growth accounting exercise	2.10%

Table 6: Overview of studies' findings on the impact of migration on the labour market

Author	Year	Title	Location	Main Findings
Borjas	2005	The Economic Benefits from Immigration	USA	The short-term impact of immigration on wages and employment of existing workers depends on the extent to which the skills of migrant workers are complements or substitutes to the skills of existing workers.
Migration Advisory Committee	2018	EEA migration in the UK: Final report	UK	Immigration has little or no impact on average employment or unemployment of existing workers. However, workers at opposing ends of the income scale are affected in different ways. The impact may also depend on the economic cycle.

Borjas et al	1997	How Much Do Immigration and Trade Affect Labor Market Outcomes?	USA	Increasing immigration and trade flows haven't been substantial enough to explain the widening gap of the wage structure ("hollowing-out" of the labour market) from 1980-1995 and have played only a limited role in the growing high school-college wage differential. However, immigration and trade flows account for half of the decline in relative wages of high school dropouts in this period, mainly because there has been a significant flow of less educated workers into the US.
Devlin et al	2014	Impacts of migration on UK native employment: An analytical review of the evidence	UK	The impact of migration on the labour market depend on a range of factors that vary over time. When the economy is strong, there isn't evidence that migration has led to the displacement from employment of UK-native workers. Some short-term impacts have been observed when the economy is in recession. Where there has been a displacement effect from a specific cohort of migrants, these evaporate over time as the labour market, which is generally a lagging indicator, adjusts.
Dustmann et al	2005	The Impact of Immigration on the British Labour Market	UK	Immigration has no effect on the overall employment outcomes of UK-born workers. It has a negative impact employment of UK-born workers with intermediate education and a positive impact on those with A-levels or university degrees.
Dustmann et al	2012	The Effect of Immigration along the Distribution of Wages	UK	Immigration positively impacts the wages of most workers but reduces wages for those lower down the wage scale. The report found that a 1 percentage point increase in the ratio of migrants to non-migrants leads to a 0.6% decrease in wages for workers at the 5th earnings percentile and a 0.5% decrease at the 10th percentile.
Lemos et al	2008	New labour? The impact of migration from central and eastern European countries on the UK labour market	UK and EU-8	This paper analyses the effect of migration of workers from EU-8 countries to the UK on claimant unemployment. The announcement of the EU enlargement in 2004 effectively works as an exogenous supply shock. They found that the impact on the labour market was negligible, stating that there is "little hard evidence that the inflow of EU-8 migrants contributed to a fall in wages or a rise in claimant unemployment in the UK between 2004 and 2006".
Manacorda et al	2012	The Impact of Immigration on the Structure of Male Wages: Theory and Evidence from Britain	UK	Analysing data from 1975-2005, they conclude that the principal impact of greater immigration is on the wages of migrants who are already in the UK. This study divided the national labour market by skills groups rather than geographic area.
Nickell and Salaheen	2015	The Impact of Immigration on Occupational Wages: Evidence from Britain	UK	Immigration has a significant but small, negative impact on average wages. Focusing on wage effects at the occupational level, this study found that, in the unskilled and semi-skilled service sector, a 1 percentage point rise in the share of migrants reduced average wages in that occupation by about 0.2%.
Reed and Latorre	2009	The Economic Impacts of Migration on the UK Labour Market	UK	The overall effects of immigration on both wages and employment are very small, so migration should be of limited concern with regards to labour market policies. A one percentage point increase in the share of migrants in the UK working-age population would reduce wages by 0.3%. By comparison, the effect of increasing the proportion of the UK-born population who leave school aged 17-19, rather than at 16, would be to increase wages by 10%, 35 times larger than the effect of a 1% increase in the share of migrants in the UK working-age population.



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