Assessment and recommendations

- *Well-being is high but the economy is weak*
- *Restoring competitiveness and fiscal sustainability*
- *The government has ambitious structural reform plans*
- *Investing in the future is essential*

Finland has been hit hard by several shocks, in addition to the global economic slowdown. Electronic exports, demand for paper and exports to Russia have collapsed. This has durably lowered the economic growth potential. Furthermore, the population is ageing rapidly. Against this background, the key messages of this Survey are:

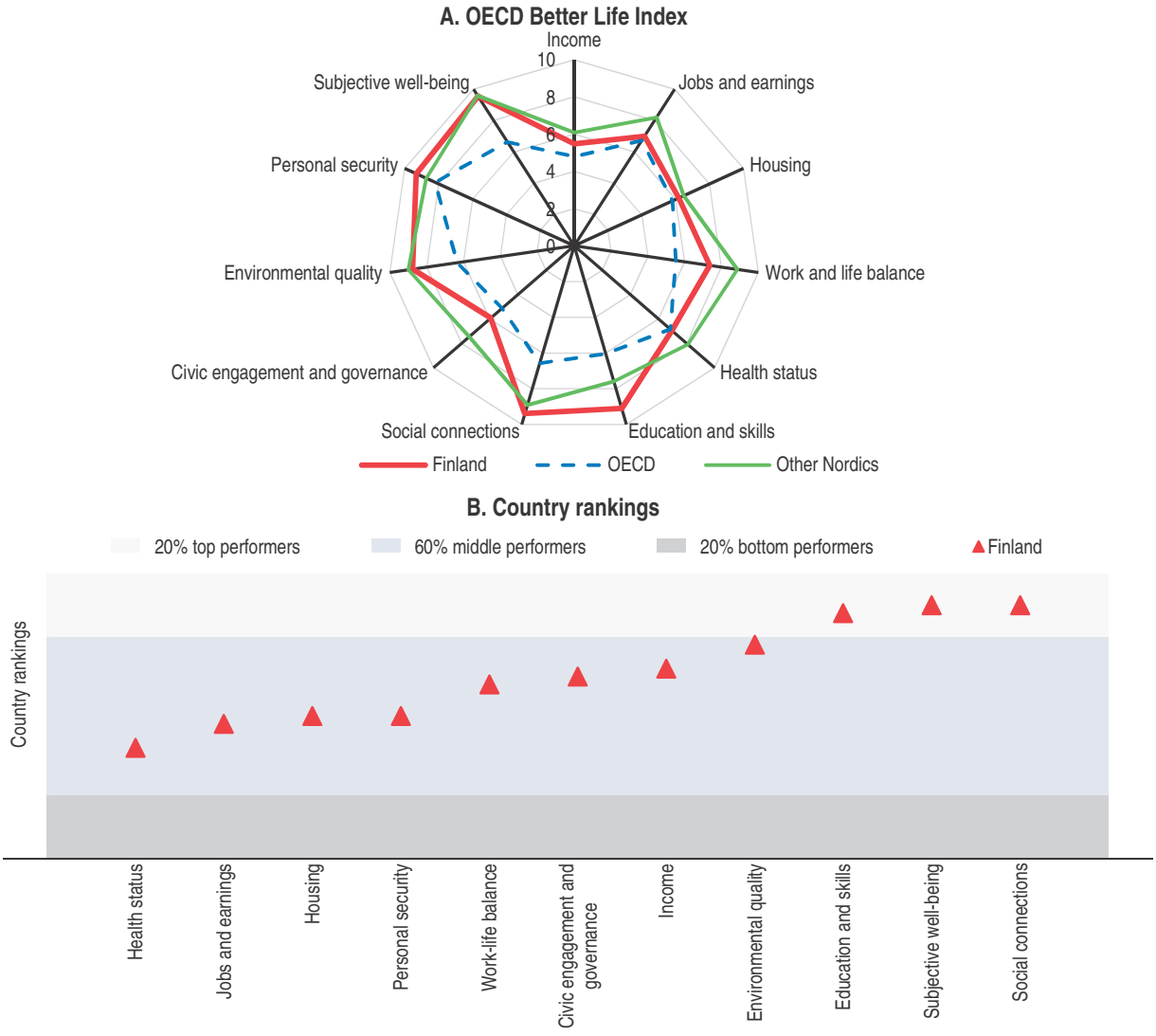
- Public finances need to be consolidated at a gradual pace to preserve the incipient recovery.
- Boosting productivity growth, by improving framework conditions and supporting innovation, is necessary to raise living standards and well-being for all.
- Raising employment, through further investing in workers' skills and enhancing labour market flexibility and work incentives is necessary to boost inclusive growth.

Well-being is high but the economy is weak

Finland has enjoyed strong economic progress over the past decades, which is reflected in high living standards and well-being (Figure 1). The country stands out for high subjective well-being, education and skills, environmental quality and personal security. The government has pledged to continue encouraging low-emission energy sources through taxation and supporting the bio-economy and clean technologies. Education performance remains excellent, but has weakened somewhat over recent years and forthcoming budget cuts will need to be compensated by efficiency gains to maintain world-class results. Housing conditions are better than the OECD average. Health conditions are similar to the OECD average and there are large inequalities across regions and socio-economic groups (*OECD Economic survey of Finland, 2012*). As the population ages, and with technological advances and patients' expectations putting pressure on costs, reducing the fragmentation of the health care system and striking a better balance between specialised and primary care will be essential to ensure both fiscal sustainability and well-being in the long term. This will require the successful implementation of the social welfare and health care reform that is to enter into force in 2019.

Inequality in Finland, as measured by the Gini coefficient of disposable income, is among the lowest in the OECD (Figure 2) and has stayed fairly constant since the turn of the century, following a sharp increase in the 1990s. The ratios of high and median to low incomes show similar patterns. Absolute poverty, measured as material and housing deprivation, is among the lowest in the EU. With a relatively compressed wage distribution, the main drivers of income are employment and productivity. The non-employed have significantly lower average incomes despite a relatively generous social safety net. The median income is almost 50% lower for the unemployed compared to the employed, and 35% lower for the inactive. The retired are less disadvantaged despite a low average retirement age compared to the other Nordics. Hence, raising employment through a better functioning labour market and investment in skills is the best way to promote inclusive growth (Pareliussen, 2016).

Figure 1. **Well-being remains high**



Note: On panel A, indicators are normalised to range between 0 (worst) and 10 (best).
Source: OECD, *Better Life Index database* (2015).

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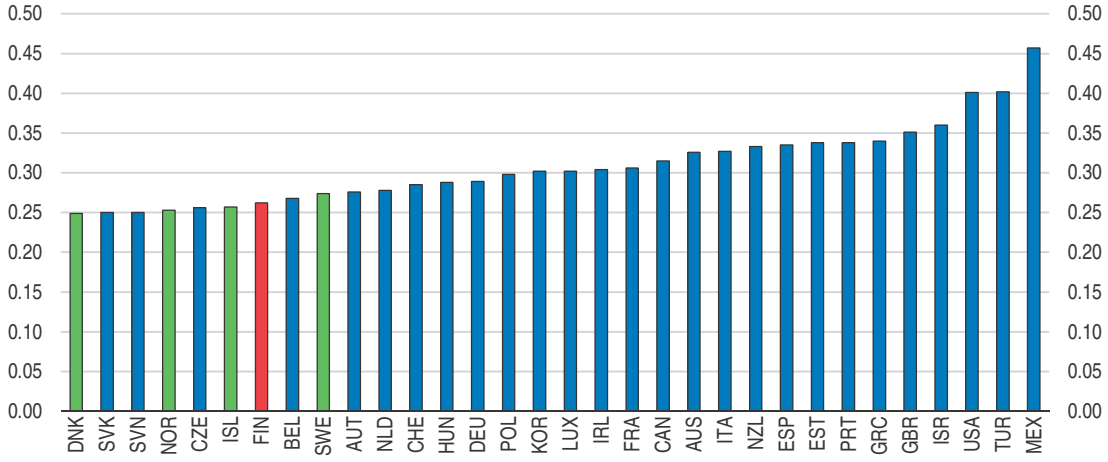
The main policy challenge in Finland is to maintain the high level of well-being, which would be eroded by continuing economic weakness. The Finnish economic and social model is being challenged, notably by tougher international competition and population ageing, and is evolving (Valkonen and Vihriälä, 2014). Further structural reforms are needed to restore competitiveness, raise productivity and boost employment. Even though Finland is still doing better than the OECD average in terms of levels of income and jobs, recent economic performance is eroding this advantage. Output remains nearly 7% below its late-2007 peak (Figure 3, Panel A). The unemployment rate has been rising steadily since April 2012 (Panel B). Exports are of key importance for a small open economy like Finland, but are at about 20% below pre-crisis levels. The recession and increasing age-related costs are taking their toll on public finances, and hence the general government deficit exceeded 3% of GDP in 2014 for the first time since the mid-1990s.

Figure 2. **Income inequality is low**

Gini coefficient post taxes and transfers, 2012 or latest year available



Source: OECD, *Income Distribution and Poverty database.*

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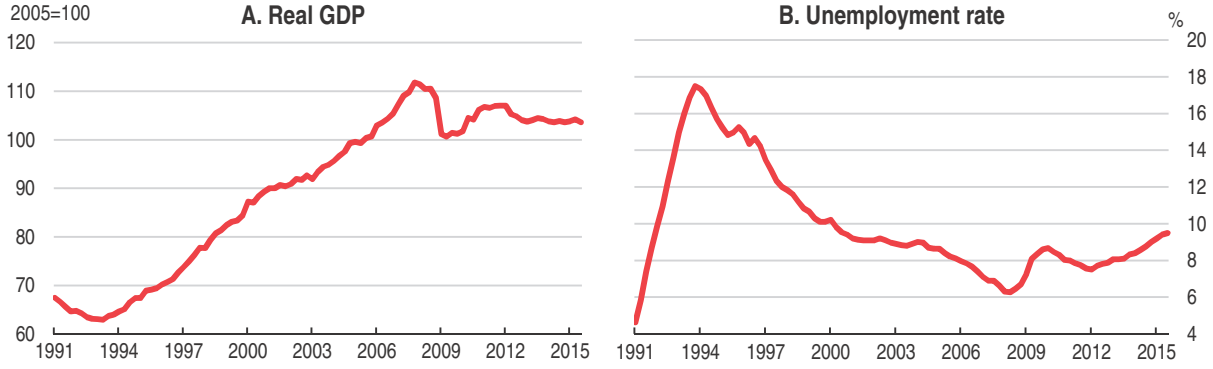
Figure 3. **The economy is weak**



Source: OECD, *Economic Outlook database.*

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A modest recovery is projected in the coming years. It hinges on stronger exports, as slow household income growth, uncertainty and cuts in public spending will hold back domestic demand. Hence, the recovery is strongly dependent on global economic developments, which are subject to high uncertainty. Higher exports are projected to reduce spare capacity, thereby reviving private investment. Public investment will be raised by spending on transport, energy and water supply infrastructure. Altogether, investment is projected to increase in 2016. Unemployment will creep up, as firms will intensify utilisation of their manpower before hiring. Inflation is projected to increase somewhat over the projection period.

Short-term risks are tilted to the downside. As a small open economy, Finland is very dependent on exports. Weaker-than-expected global growth and especially low global investment would hinder the recovery, while a pick-up would boost the economy. Turbulences in global financial markets could result in an increase of the cost of financing for the government and firms alike, although Finland has so far rather been considered as a safe haven. Vulnerabilities over a longer horizon are more diverse (Box 1).

Table 1. **Macroeconomic indicators and projections**

	2013	2014	2015	2016	2017
GDP	-1.1	-0.4	-0.1	1.1	1.6
Private consumption	-0.3	0.5	0.4	0.4	0.8
Government consumption	0.8	-0.2	0.3	1.3	1.0
Gross fixed capital formation	-5.2	-3.3	-0.9	3.7	3.1
Housing	-5.2	-5.9	-0.9	4.0	3.0
Business	-8.2	-2.9	-0.5	4.0	3.0
Government	3.5	-0.9	-1.7	2.4	3.7
Final domestic demand	-1.1	-0.5	0.1	1.3	1.4
Stockbuilding[1]	0.0	-0.5	0.5	0.0	-0.1
Total domestic demand	-1.1	0.1	-0.4	1.2	1.4
Exports of goods and services	1.1	-0.7	0.6	3.3	4.0
Imports of goods and services	0.0	0.0	-0.4	2.6	3.4
Net exports[1]	0.4	-0.3	0.4	0.3	0.3
Other indicators (% growth rates, unless specified)					
Potential GDP	0.5	0.5	0.6	0.7	0.7
Output gap[2]	-3.8	-4.7	-5.3	-5.0	-4.1
Employment	-1.0	-0.4	-0.7	-0.3	0.0
Unemployment rate[3]	8.2	8.7	9.4	9.7	9.8
GDP deflator	2.6	1.6	0.2	0.9	1.2
CPI	2.2	1.2	-0.2	0.4	0.8
Core inflation	1.8	1.6	0.8	0.8	0.9
Household saving ratio, net[4]	1.3	-0.3	0.8	1.5	1.4
Trade balance[5]	-0.8	-0.8	-0.2	-0.2	0.1
Current account balance[5]	-1.7	-0.9	-1.0	-0.7	-0.4
General government financial balance[5]	-2.5	-3.3	-3.3	-2.7	-1.6
Underlying government net lending[2]	-0.3	-0.3	0.1	0.5	1.0
Underlying government primary balance[2]	-0.2	-0.1	0.4	0.7	1.1
Gross government debt (Maastricht)[5]	55.6	59.3	60.6	62.7	65.0
General government net debt[5, 6]	-54.0	-54.0	-50.7	-47.0	-44.0
Three-month money market rate, average	0.2	0.2	0.0	0.0	0.1
Ten-year government bond yield, average	1.9	1.4	0.7	0.7	1.0

1. Contribution to changes in real GDP.
2. As a percentage of potential GDP.
3. As a percentage of labour force.
4. As a percentage of household disposable income.
5. As a percentage of GDP.
6. The assets of Finland's private pension system are included in the general government's assets, but the liabilities of the private pension system are not included in general government gross debt.

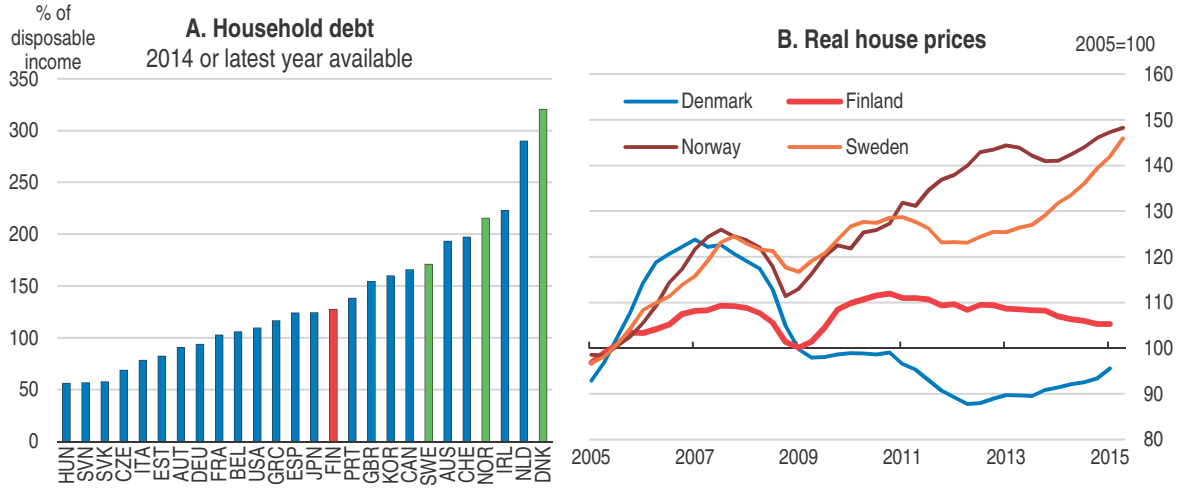
Source: OECD, *Economic Outlook 98 database*.

The main domestic financial vulnerability relates to high household debt, even though it is lower than in the other Nordics (Figure 4, Panel A). High loan-to-value (LTV) mortgages are common in Finland (FIN-FSA, 2012), and most mortgages carry variable interest rates. Heavily indebted households are vulnerable to higher interest rates, losses in income or falls in housing prices. At the same time, there is no sign of a housing bubble, as housing prices have been broadly flat for more than a decade (Figure 4, Panel B). Furthermore, two policy measures will reduce risks. Mortgage interest tax deductions are being cut in steps; and from June 2016 a maximum LTV ratio of 90% (95% for first-time buyers) will be imposed. Housing loans account for about 60% of bank lending and risk weights computed through banks' internal models range between 6 and 13%, compared to 35% under the standardised approach. There may be a case for introducing minimum risk weights on mortgages, as in Norway and Sweden, and to encourage harmonisation of risk-weight calculations across banks (Bank of Finland, 2015a).

Box 1. **Shocks that might affect economic performance**

Vulnerability	Possible outcome
Euro area turbulence	Finland has little exposure to the most vulnerable euro area countries. However, financial turmoil could affect bond yields and financial conditions in Finland and other euro area countries. A euro-area wide recession would affect Finnish exports, although a weaker euro could boost exports to countries outside the euro area.
Deepening recession in Russia and further political tensions between Russia and the European Union	A further deterioration of economic conditions in Russia would reduce exports, even though the share of Russia in Finnish exports has already shrunk considerably. Escalating political tensions could lead to damaging sanctions on both sides.
Global or regional financial crisis contagion	The Finnish financial system is dominated by Nordic banks, which have low liquidity buffers. A liquidity crisis triggered by events outside Finland could lead to difficulties in the banking sector, falls in asset prices and a credit squeeze, which would cause a deep recession.

Figure 4. **Household debt is relatively high but housing prices are stable**



Source: OECD, *Economic Outlook database*.

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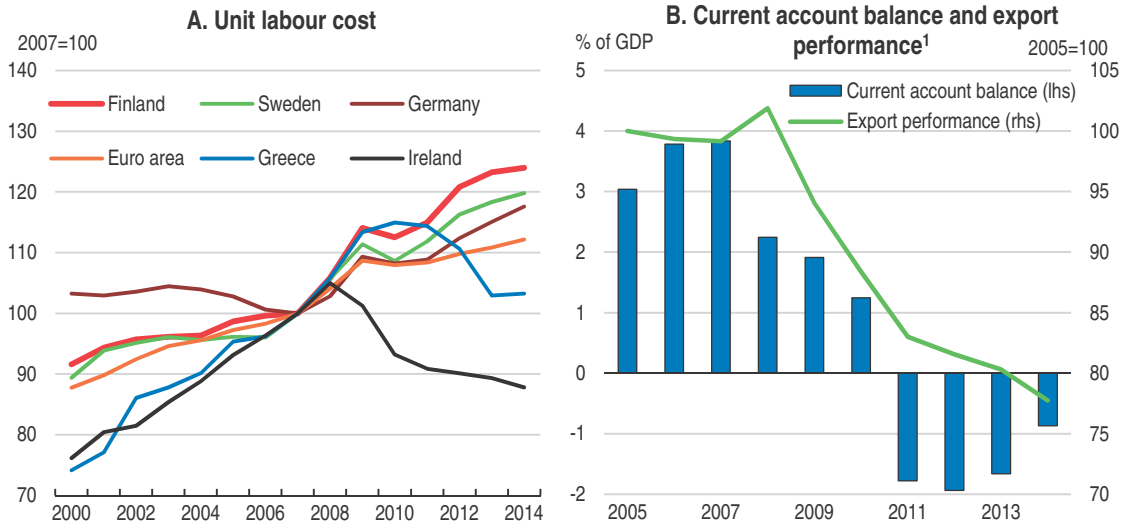
The economic downturn is largely structural, insofar as it reflects downsizing in industries such as electronics and forestry. Estimating potential output is challenging at a time of unusually large structural changes and output gap estimates vary widely. The fall in value added from electronics has reduced GDP by about 3% since the end of 2007. The decline in manufacturing of wood and paper started around the turn of the century and has cut GDP by around 0.75% since 2007. In addition, Finland's growth potential is being eroded by a rapidly ageing population. Sluggish global growth, low demand for investment goods in which Finland specialises, and the recession in Russia have dragged down Finnish exports. The value of exports of goods to Russia has fallen by roughly half over the past three years, subtracting about 1.5% from Finnish GDP. In addition, unit labour costs increased more than for the country's main trading partners (Figure 5, Panel A). Although the fall in exports is mostly due to non-cost factors, better cost-competitiveness could have mitigated the effects of the shocks mentioned above. Finland has lost market share, and

Figure 5. **Finland has lost strength on foreign markets**



1. Ratio of exports to export markets (trade-weighted average of trading partners' imports). A decrease indicates a loss in export market shares.

Source: OECD, *Economic Outlook database*.

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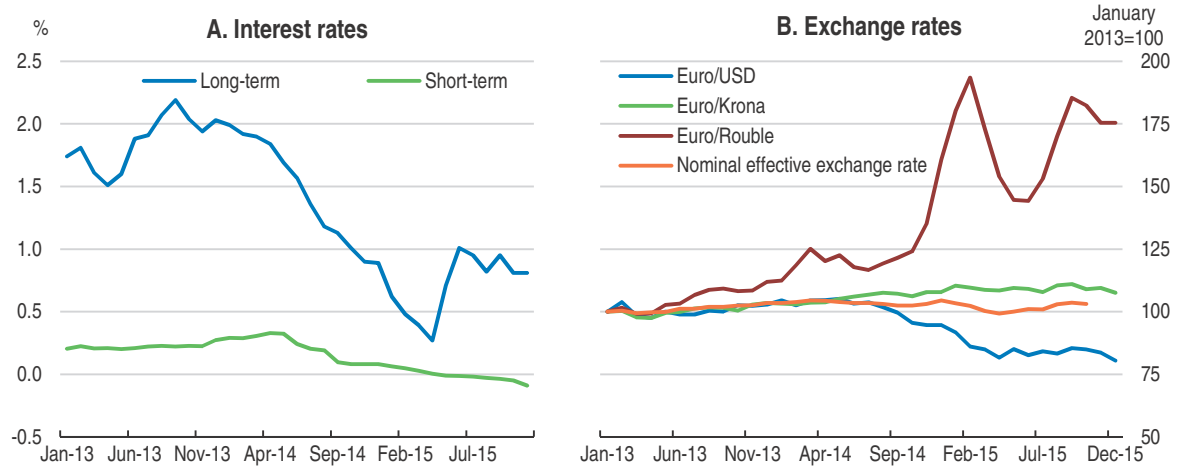
restoring competitiveness is a policy priority (see below). The current account balance moved from a surplus of nearly 4% of GDP in 2007 to a deficit close to 2% in 2011 (Panel B). The deficit has shrunk since then, with weak domestic consumption and exports leading to a fall in imports and lower energy prices improving terms of trade. Finland's net international investment position is positive and external sustainability is not a concern (European Commission, 2015a).

The European Central Bank's (ECB) asset purchase programme and near zero interest rate have alleviated the financial burden of households and firms. In particular, mortgage interest rates have followed policy rates down. The Bank of Finland estimates that the ECB asset purchase programme will raise GDP by about 0.3 percentage points cumulatively in 2015-16. This estimate, however, does not take into account the effect on Finnish exports of higher growth in other euro area countries, which could be substantial. ECB asset purchases have lowered government bond yields somewhat (Figure 6, Panel A). The euro has depreciated by about 20% against the dollar since mid-2014, which provides a welcome boost to Finnish competitiveness, as about two-thirds of Finnish exports go outside the euro area. However, the positive impact of the depreciation of the euro against the dollar is partly offset by its appreciation against the Swedish krona and the Russian rouble (Panel B).

Finland's large surpluses in the years preceding the global financial and economic crisis meant fiscal policy could support activity, including with a stimulus package in 2009-10. The fiscal stance has been mildly restrictive since then, and is likely to remain so. The government seeks to cut the budget deficit, which is now slightly over 3% of GDP, and to stem the rise in gross debt, which will exceed 60% of GDP in 2015. The government's programme aims at permanent annual savings of €4 billion (about 2% of GDP) by 2019, mostly through spending cuts. It also contains one-off increases in public investments of €1.6 billion by end-2018. Furthermore, the government has initiated the social welfare and health care reform, set to come into force in 2019. The permanent annual savings target for

Figure 6. **Financial conditions are supportive**



Note: Long- and short-term interest rates refer to respectively 10-year government bond and 3-month money market yields.
Source: Bank for International Settlement, Thomson Reuters.

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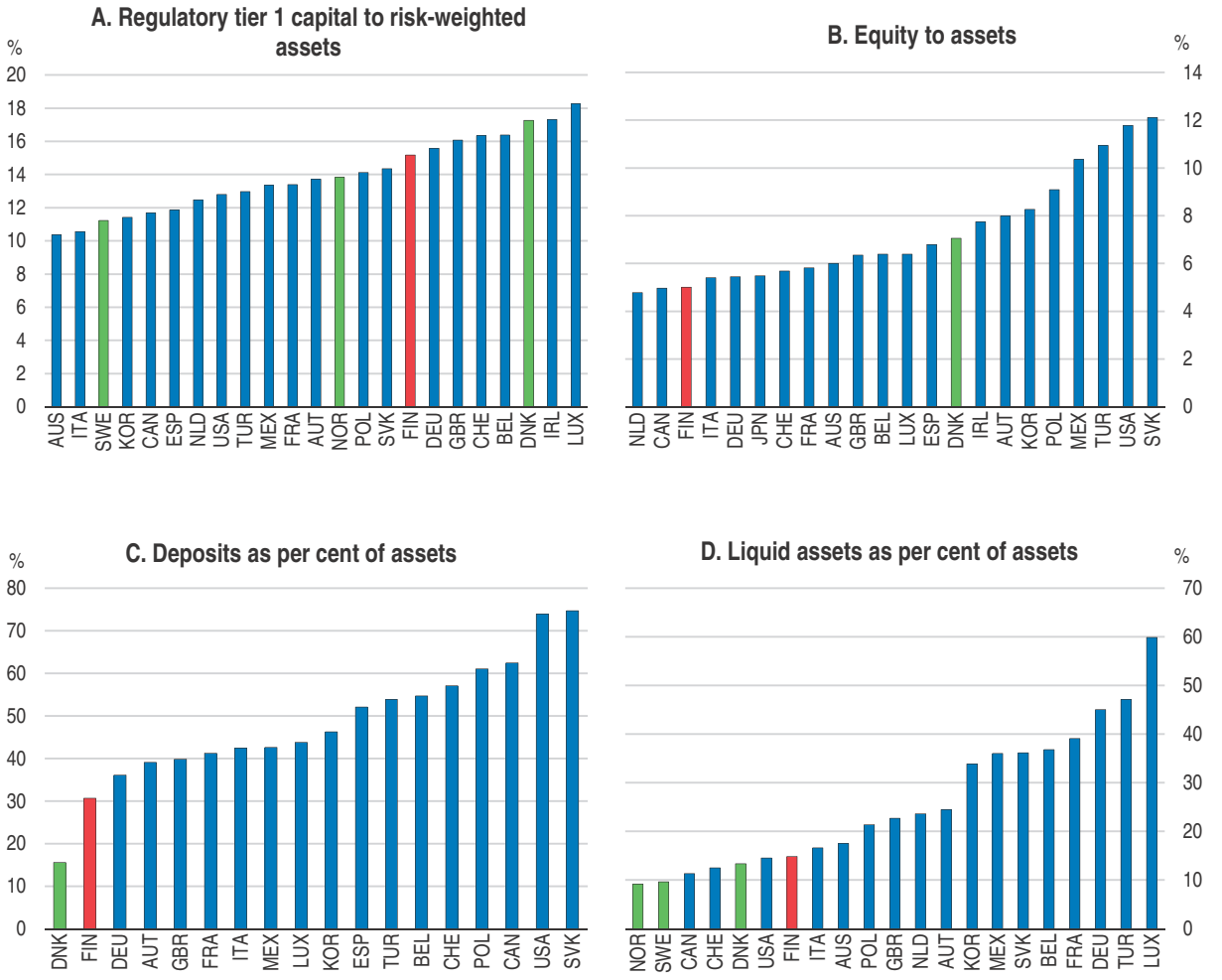
the reform is €3 billion (about 1.5% of GDP) by 2029 relative to the no-policy action baseline. Fiscal consolidation will slow growth in the short term. However, the size of the fiscal multiplier is very uncertain. On the one hand, Finland is a small open economy with a well-functioning financial system, which suggests a small multiplier. On the other hand, there is ample spare capacity in the economy, little prospect of further easing of financial conditions and spending multipliers tend to be higher than tax multipliers in downturns (Batini et al., 2012).

The financial system has withstood the downturn well. Access to credit has remained relatively easy, even though it has tightened somewhat for small companies as the downturn lingered. Bank capital buffers have been reinforced and tier 1 capital now exceeds 15% of risk-weighted assets (Figure 7, Panel A). Nevertheless, Finnish banks' balance sheets amount to about 250% of GDP and the banking system is the most concentrated in the European Union. Hence, difficulties in a major bank could rapidly spread across the financial system and the economy. As the Finnish banking system is strongly interconnected with those of other Nordic countries, it is vulnerable to shocks occurring in the region, which calls for continued tight co-operation between Nordic regulators and supervisors. Such co-operation will become even more important if Nordea, which accounts for about 30% of Finnish bank loans and deposits, goes ahead with its plan to convert its Finnish subsidiary into a branch. Additional capital requirements will be imposed on four systemically important financial institutions from January 2016. While these institutions already meet the new capital standards, the decision brings Finnish capital requirements close to those of other Nordic countries, which is crucial to avoid regulatory arbitrage within regional banking groups.

The banking system is strong and there is no sign of asset bubbles. However, some structural features of the banking system make it vulnerable in the event of an international liquidity crisis. Although the tier 1 capital ratio is high, the overall equity-to-asset ratio is one of the lowest in the OECD, reflecting the large share of mortgages with low risk weights in bank balance sheets (Figure 7, PanelB). Banks depend on short-term wholesale funding, especially from abroad, which exposes them to risks in the case of a

Figure 7. **Some vulnerabilities remain in the banking system**

2013



Note: Data cover domestically incorporated, domestically controlled entities, as well as domestically incorporated subsidiaries of foreign entities, along with these entities' branches and subsidiaries.

Source: IMF, *Financial Soundness Indicators database*.

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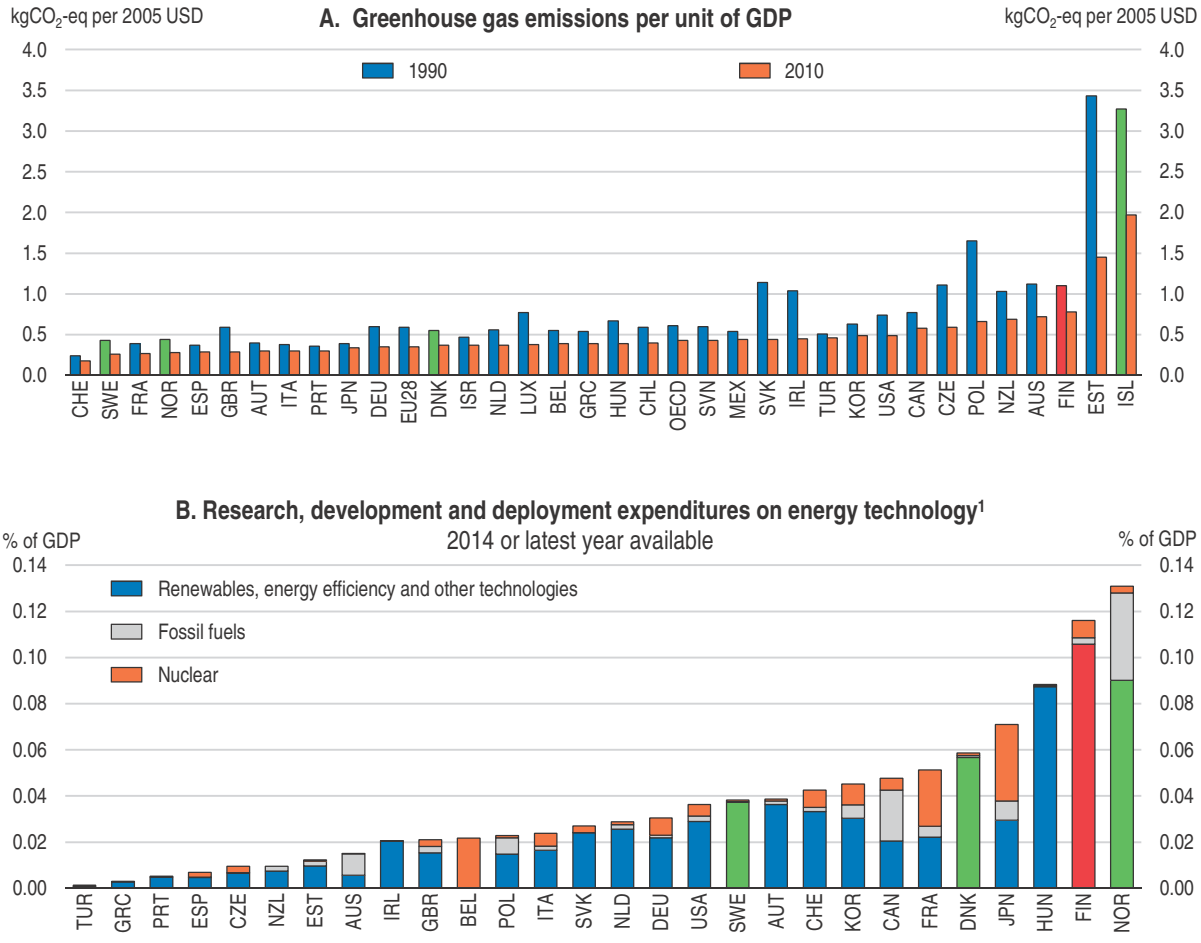
European or global liquidity crisis. Deposits account for only about 30% of assets, one of the smallest proportions in the OECD (Panel C). Furthermore, the share of liquid assets in total assets remains fairly small, even though it has increased in recent years (Panel D). Further reinforcing liquidity buffers would reduce Finland's vulnerability to potential disruptions in global financial markets.

Growth is becoming greener

Finland enjoys an abundant supply of clean water, and air quality is better than the OECD average, despite some local particle pollution from the widespread use of woodstoves for heating. The longstanding use of economic instruments, especially taxation, to promote green growth, has reduced greenhouse gas emissions intensity considerably since 1990, but it is still the third highest in the OECD because of the importance of energy intensive industries, the cold climate and long transport distances

(Figure 8, Panel A). The share of clean and nuclear energy in energy supply is one of the highest in the OECD. Further increases are planned and supported by policy, notably within biomass, wind, biofuels and nuclear power. In 2014, total R&D spending on energy technologies amounted to nearly 0.12% of GDP, the highest among OECD countries, with the largest share devoted to renewables and energy efficiency (Panel B). The private sector accounts for around 70% of total energy R&D expenditure.

Figure 8. **Emission intensity should be reduced and R&D can help**



1. Based on total public RD&D, including government, public agencies and state-owned enterprises.

Source: International Energy Agency, CO2 Emissions from Fuel Combustion Statistics and *Energy Technology R and D databases*.

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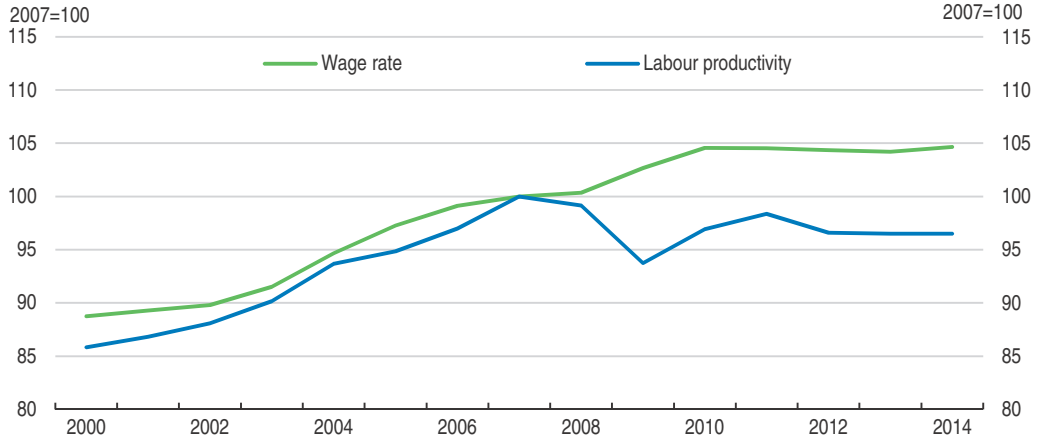
Finland is obliged to reduce domestic emissions by 16% by 2020 under the EU Effort Sharing Decision. Furthermore, it has pledged to reduce domestic emissions by 80% by 2050 (OECD, 2015a). Environmental policies are already stringent, but stringent policies do not harm productivity and competitiveness if they are flexible and do not hinder competition (Albrizio et al., 2014). However, they may shift comparative advantages, accentuating the need for structural change (Kozluk and Timiliotis, 2016). Additional measures should therefore target environmentally harmful subsidies and tax expenditures, and enhance the efficiency of environmental regulation and direct support.

Restoring competitiveness and fiscal sustainability

Competitiveness has been eroded

Wages continued to progress steadily after the onset of the 2008 global crisis even as productivity growth slowed sharply, in line with the generous 2007 multi-year wage agreement (Figure 9). The wage agreement reached in 2013 has led to slow wage growth since, and wage moderation is also expected going forward. However, as wage growth is also subdued in most of Finland's trading partners, regaining cost-competitiveness will take time. The government estimates that Finland's cost-competitiveness has deteriorated by 10 to 15% compared to its main trading partners over recent years (Prime Minister's Office, 2015). It aims at closing this gap, through three types of measures, each yielding a unit labour cost reduction of 5%: a one-off cut in labour costs; wage moderation over the coming years; and productivity gains at the firm level generated by enhanced flexibility, notably in wage negotiations. The government had proposed a social contract, which included an increase of 5% in working time for the same pay. This would have speeded up the catch-up in cost competitiveness, but the social partners have so far failed to reach an agreement. In the absence of an agreement, the government is pushing forward measures to shorten annual leave, convert two public holidays into unpaid holidays, reduce sick-leave benefits and cut employer social security contributions.

Figure 9. **Wages have outpaced productivity**



Source: OECD, *Productivity and Analytical databases*.

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Non-cost competitiveness has also deteriorated. Some Finnish products have become less demanded on world markets, notably electronic products, as Nokia missed the "smartphone revolution", and pulp and paper, as a consequence of the development of digital media and increased competition from other countries. The electronics and ICT industries, including computer games, are restructuring and should be able to contribute to growth again, although not on the same scale as in the early 2000s. The paper industry is renewing itself as well, focussing on markets where Finland has a comparative advantage over emerging economies because of the type of wood fibres it produces, and pursuing environmentally-friendly strategies, including the development of bio-energy from by-products. The chemical industry has expanded and shipbuilding is reviving, partly

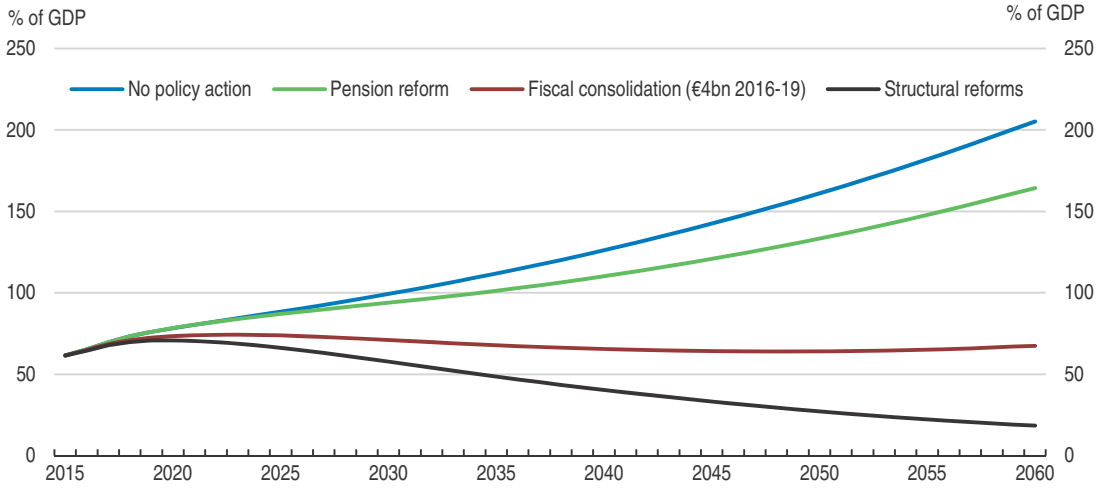
based on its capacity to produce greener ships propelled by liquefied natural gas. Nevertheless, finding new sources of growth through innovation and entrepreneurship will be needed for a sustained revival of export growth.

Government debt would continue to rise without policy action

Gross government debt (Maastricht definition) has increased from below 40% of GDP before the 2008 crisis to above 60% of GDP in 2015. Finland had net government assets of about 50% of GDP in 2015. However, this strong net asset position essentially reflects the recording in the government balance sheet of the financial assets of Finland's private pension system, but not of the corresponding liabilities. With a deficit exceeding 3% of GDP and age-related expenditures rising rapidly, debt will increase further in the absence of policy action. A "No policy action" scenario based on OECD long-term growth scenarios, pension projections and public health and long-term care expenditure projections, suggests that gross government debt would reach 100% of GDP by 2030 and 200% by 2060 if nothing is done to tackle these challenges (Figure 10). These estimates are subject to a number of assumptions, but are broadly in line with estimates from the Bank of Finland (2015b) and the Finnish Economic Policy Council (Economic Policy Council, 2015). The "Pension reform" scenario, shows the impact on public debt of the pension reform which is set to be implemented from 2017. It is estimated to lower debt by about 5 percentage points of GDP in 2030 and about 40 percentage points in 2060, but would not prevent a rising public debt-to-GDP ratio (the underlying assumptions are described in Annex 2).

The government programme, if successfully implemented, is adequate to restore fiscal sustainability through budget measures and structural reforms. The "Fiscal consolidation" scenario in Figure 10 shows the estimated cumulative impact on public debt of the pension reform and fiscal consolidation. The "Structural reforms" scenario adds to the latter the impact of product and labour market reforms (the latter are discussed at length further

Figure 10. **Gross government debt scenarios**



Note: The impact of measures shown is cumulative. First, implementation of the pension reform is assumed and subsequently fiscal consolidation and structural reforms are introduced in steps. Structural reforms consist of product market reforms, which raise productivity growth by 0.5% per year, and labour market reforms, which raise labour participation to the average of the other Nordics.
Source: OECD calculations.

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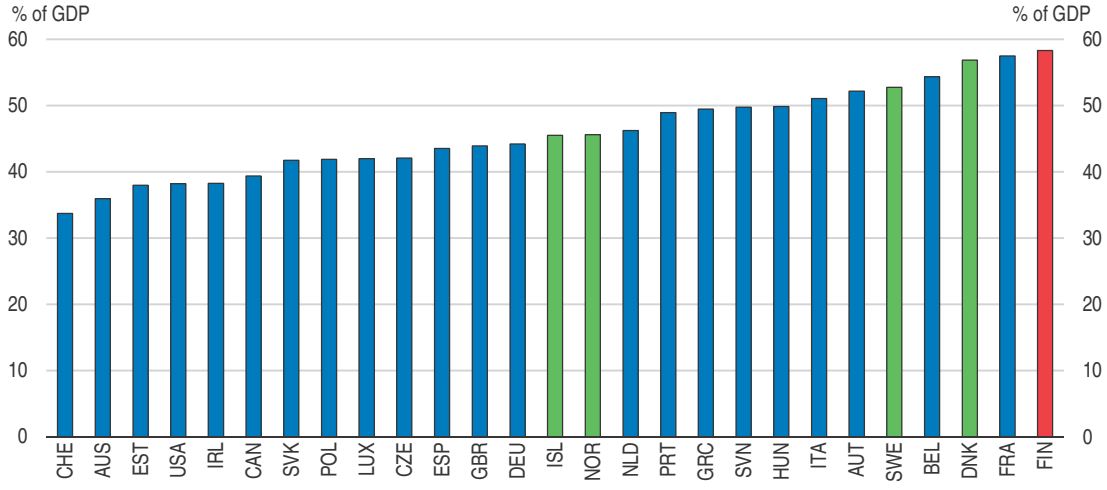
below). The fiscal consolidation plan of €4 billion (2% of GDP) over 2016-19 is set to lower public debt to about 70% of GDP by 2030. Structural reforms pushing up productivity growth by 0.5 percentage point and raising the employment rate to 72% by 2023 would bring the debt ratio down further, to around 60% in 2030 and 20% in 2060.

The fiscal consolidation plan of €4 billion, of which €3.2 billion of spending cuts, over 2016-19 will bring the budget deficit below 3% of GDP by 2017, assuming no major macroeconomic shock. The main planned spending cuts concern social benefits, education and research. As many benefits are universal, the impact of cuts will be spread widely across the population, while strong social safety nets protect the most vulnerable. Besides, reforming unemployment benefits is necessary to enhance work incentives and raise employment over time. Cuts to education and research will need to be compensated by efficiency gains, to avoid affecting the quality of services and the economy's growth potential (see below). Service fees for some health and social services will also increase, but from generally modest levels. The impact of spending cuts on growth is mitigated by one-off spending on key projects financed through the government's balance sheet. Nevertheless, general government debt is set to continue to rise until the early 2020s, when it would peak slightly above 70% of GDP.

Government spending is high relative to GDP in Finland (Figure 11). Between 2008 and 2014, it increased by 10 percentage points, almost half of which is due to higher social benefit payments, mainly related to ageing and higher unemployment. Government consumption also increased markedly as a share of GDP. Although this increase is partly due to wage increases, non-wage expenditure also went up substantially. The increase in spending caused the deterioration of the fiscal position, accentuated by falling GDP. The share of receipts from indirect taxes, personal income taxes and social contributions moved up, while that of corporate income tax revenues fell, both as a result of tax rate cuts and lower corporate profits (Table 2).

Figure 11. **Government spending as a share of GDP is the highest in the OECD**

2014



Source: OECD, *Economic Outlook database.*

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Table 2. **Social benefits and public consumption have driven up public expenditure**

As a percentage of GDP

	Level			Change		
	2001	2008	2014	2001-14	2001-08	2008-14
Total expenditure	**47.3**	**48.3**	**58.3**	**11.0**	**1.0**	**10.0**
Of which:						
Consumption	20.0	21.7	24.8	4.8	1.7	3.1
Of which:						
wages	12.6	12.9	14.2	1.6	0.3	1.3
Social benefits	15.3	14.7	19.6	4.3	-0.6	4.9
Total receipts	**52.3**	**52.4**	**54.9**	**2.6**	**0.1**	**2.5**
Of which:						
Direct taxes						
Households	14.1	13.2	14.2	0.1	-0.9	1.0
Corporations	4.3	3.6	2.3	-2.0	-0.7	-1.3
Indirect taxes	12.9	12.4	14.0	1.1	-0.5	1.6
Social contributions	11.8	11.6	12.8	1.0	-0.2	1.2

Source: OECD, *Economic Outlook database*.

The government has ambitious structural reform plans

Weak growth and productivity point to the need for structural reforms. Previous governments have taken action, often in line with OECD recommendations (Table 3). Still, more reforms are needed to restore growth and boost productivity. The current government has an ambitious reform agenda, which includes reforming the tax structure, the labour market, education, health care and social services, as well as promoting entrepreneurship. Labour market reforms to increase employment would have the greatest impact on Finland's output growth, especially if they were coupled with product market reforms improving the competitiveness of the economy (OECD, 2015b). As the population is ageing rapidly, the reform of social welfare and health care is also essential to ensure long-term fiscal sustainability and a high level of well-being.

The tax structure will be made more growth-friendly

The level of taxation in Finland is among the highest in the OECD, reflecting an extensive welfare system. High tax rates may be harmful to doing business, as pointed out by more than a fifth of respondents in the World Economic Forum Global Competitiveness Survey 2015-16, although they have to be weighed against the benefits generated by developed public services and infrastructure. Finland has already been moving in the direction of a more growth-friendly tax system in recent years, with cuts in corporate income tax rates, an increase in the share of indirect taxes in total taxation and increases in recurrent taxes on personal immovable property. Nevertheless, the tax wedge on labour remains among the highest in the OECD (Figure 12). The government has announced a reduction in labour taxation, notably through an increase in the earned income deduction focusing on low and medium incomes, and coordination of tax and social security measures to reduce inactivity traps. Excise duties and recurrent taxes on personal immovable property, which are less detrimental to growth, will increase. The deduction of mortgage interest rate payments from taxable personal income will be reduced further, making housing taxation more neutral. Some reforms to taxation of entrepreneurship,

Table 3. **Many earlier OECD recommendations are being followed**

Earlier OECD recommendations	Action taken or planned
Pension reform: Increase the minimum pension age gradually and limit early retirement paths (2014)	In September 2014, the social partners agreed on raising the retirement age to 65 by 2025, and thereafter to link it to life expectancy. The reform will take effect in 2017. Early retirement paths have been progressively narrowed.
Tax structure: Shift taxation from labour to recurrent taxes on personal immovable property and indirect taxes (2008, 2010)	The share of receipts from indirect taxes and recurrent taxes on personal immovable property has increased over recent years. The government plans to move further in that direction and more specifically to coordinate tax and social security measures to remove inactivity traps.
Labour market: Strengthen activation and reform unemployment benefits to improve work incentives (2012)	The Youth guarantee strengthens activation for young people. The Government will prepare a reform of unemployment security in co-operation with social partners. Activation will be enhanced and work incentives for the unemployed will be improved by lowering replacement rates, tapering benefits or a combination of the two.
Product market regulations: Increase competition in retail trade and network industries (2012)	Shops' opening hours were further liberalised in December 2015.
Local government finances and municipal reform: strengthen the fiscal framework to reinforce control over local government spending; promote the merger of municipalities or scale back their responsibilities in functions where economies of scale and scope can be achieved (2012, 2014)	Local government spending has been included in the aggregate spending limit since 2015. The previous government's plan to encourage mergers has faced strong opposition and few municipalities have merged in recent years. The current government, while still encouraging voluntary mergers, will focus on reducing municipalities' duties and obligations.
Health care and social services reform: rationalise the organisation of health services to achieve economies of scale and a better balance between primary and specialised care (2012)	The former government proposed a health care reform creating five new regional authorities responsible for organising most of health care, but the reform was ruled unconstitutional. The current government has announced the creation of 18 autonomous regions, of which 15 will organise healthcare and social services in their area themselves, while three will provide the services with the support of one of the other autonomous regions. In addition, the country will be divided into five university hospital areas providing more demanding health care. The regions will be managed by elected councils, probably with some (limited) power to collect taxes. The reform will enter into force on 1 January 2019.
Housing market reform: phase out mortgage interest deductibility, raise recurrent taxes on personal immovable property and increase the responsiveness of land-use planning (2006)	Mortgage interest deductibility is being reduced in steps. Recurrent taxes on personal immovable property have increased. The government pledged to support supply by amending land-use planning regulations and promoting competition in the construction industry.
Entrepreneurship, innovation and R&D: Maintain strong government support for basic R&D and education. Streamline the system of business support institutions and downscale public funding in areas where private alternatives exist (2012).	Team Finland has been created to coordinate the activities of several institutions, with a focus on internationalisation. Planned cuts in funding risk weakening the innovation and entrepreneurship potential of Finland.

ownership and investment are also planned (Prime Minister's Office, 2015). This includes easing the inheritance tax, which would however entail revenue losses and increase inequality (Economic Policy Council, 2015).

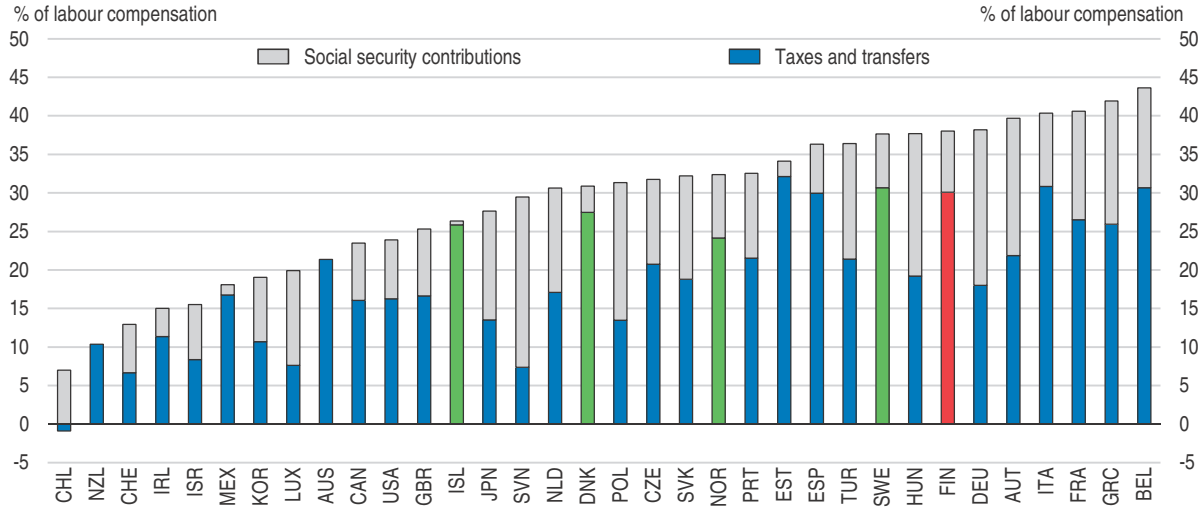
The VAT revenue ratio, which relates VAT revenues to the potential tax base, is around 55%, only slightly above the OECD average and well below that of Estonia or Switzerland (OECD, 2014a). The tax system could be further improved by taxing more goods and services at the standard VAT rate instead of at a reduced VAT rate. However, this could affect poor people more and therefore should be accompanied by compensation measures.

Enhanced work incentives will promote inclusive growth

The employment rate is lower than in the other Nordics for both genders and across most age groups (Figure 13). The government has the ambition to increase the employment rate to 72% and reduce the unemployment rate to 5% by 2019 (Prime Minister's Office, 2015).

Figure 12. **The tax wedge on labour is high**

2014



Note: Average tax wedge for a couple with two children and average earnings. Social security contributions include both employee and employer contributions. Taxes include personal income tax and any payroll tax.
Source: OECD, *Taxing Wages database*.

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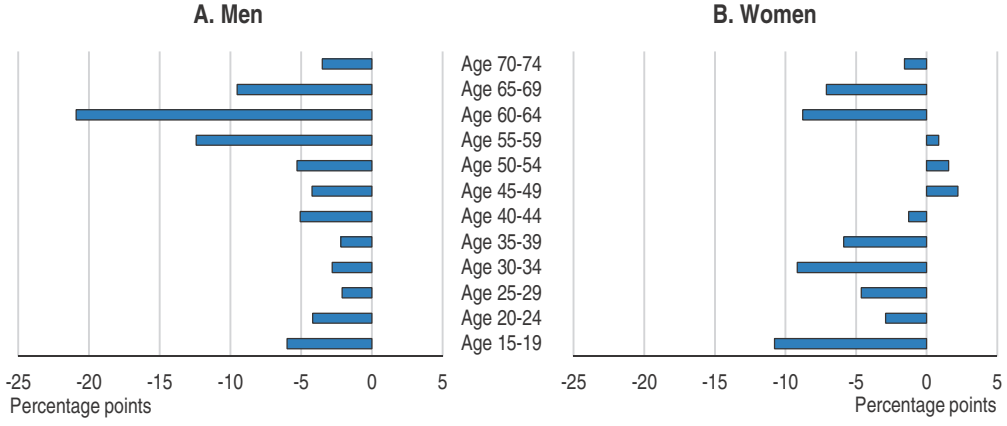
These targets seem out of reach, with the employment rate currently at 68%, the unemployment rate above 9% and significant demographic headwinds in the coming years. In the baseline OECD long-term scenario, the government target is reached only around 2050, despite significant advances in the participation rates of women and of older people. But the potential to boost employment is significant in the longer term, as illustrated by labour market participation convergence scenarios (Pareliussen, 2016). Such convergence to the other Nordics will require a comprehensive package of policy reforms targeting quicker labour market entry of youth, postponing the exit of older workers, encouraging work immigration, improving work incentives and activation policies for the unemployed and increasing the participation of women of childbearing age.

Figure 13. **Employment is low compared to other Nordics**[1]



1. Difference in employment rates between Finland and the Nordic average (Denmark, Norway and Sweden) in 2014.
Source: OECD, *Labour Force Statistics database*.

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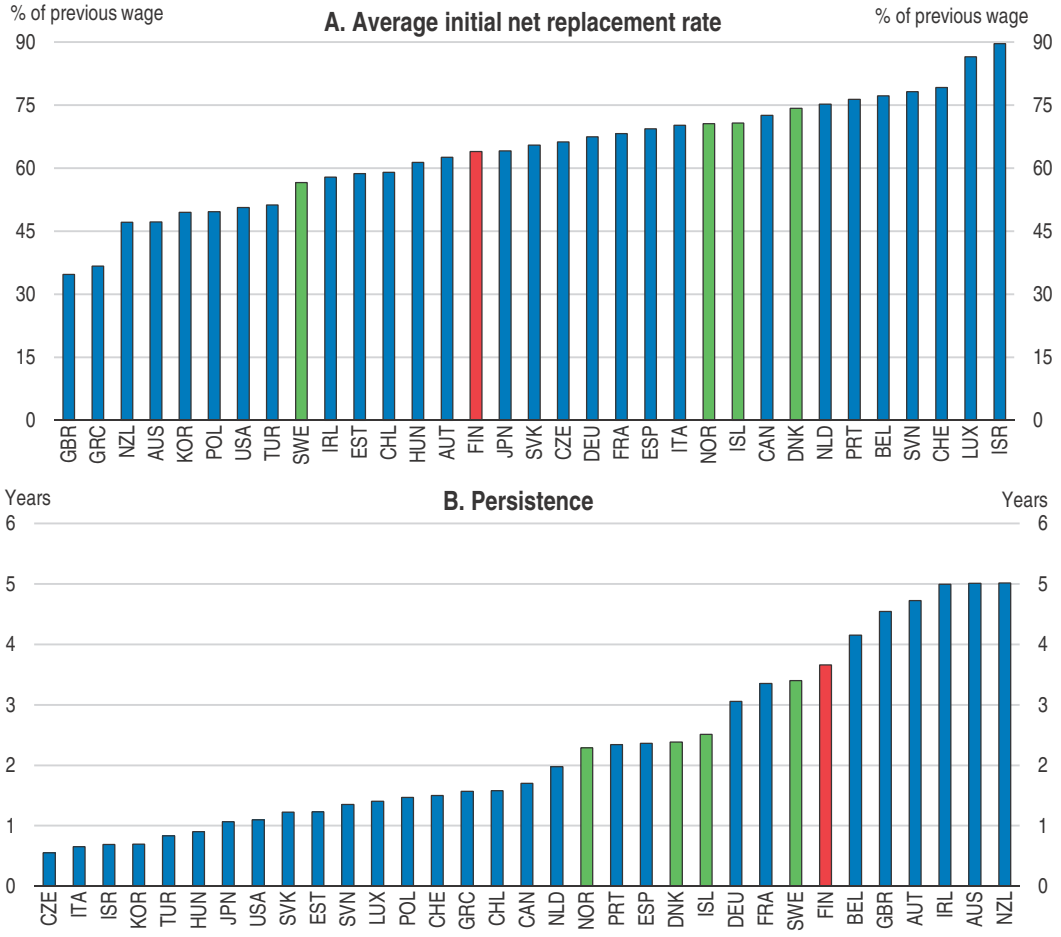
The social partners agreed on a pension reform in September 2014. Key elements of the reform include gradually raising the lower pension age limit from 63 to 65 years and linking it to longevity thereafter. The expected benefits are substantial, with on average five months added to working careers, pension expenditure reduced by around 6% and the government fiscal balance strengthened by approximately 1% of GDP once the reform is fully implemented (Economic Policy Council, 2015). In order to reap the full benefits of the reform, a new pension scheme with a lower age limit (63 years) for those who have worked for 38 years in demanding jobs should be subject to strict eligibility criteria and its age and career limits need to be adjusted to longevity. The option to extend unemployment benefits until retirement for those who are unemployed at the age of 61 should be closed, and criteria to access disability pensions should be the same for persons above 60 as for those below. Shifting the initial medical evaluation away from patients' physicians towards insurance teams would help achieve greater consistency and increase focus on medical conditions (OECD, 2014b).

The combination of fairly generous benefits, slow tapering and late activation of the unemployed distinguishes Finland's unemployment benefit system from those of the other Nordics (Figure 14). These features reduce job search intensity and prolong unemployment spells. Somewhat more generous initial benefits in Norway and Denmark are for example tapered more quickly, and more resources are spent on active relative to passive labour market policies in these countries. The government has announced a €200 million cut to unemployment insurance. Among other things, the maximum duration of unemployment benefits will be reduced from 500 to 400 days for most claimants. Reducing replacement rates during the unemployment spell could strike a balance between income security and improved work incentives. Policies to get the unemployed back to work are being consolidated, and further measures have been announced in the government programme, notably better aligning financial incentives to responsibilities in local employment services and increasing the use of private providers of employment services (Ministry of Finance, 2014, Prime Minister's Office, 2015). Introducing mandatory job search and reporting from the beginning of the unemployment spell combined with a more gradual sanction regime would be an effective and low-cost way to shorten unemployment for those who have good re-employment prospects (Martin, 2014).

The tradition of centralised wage settlements has left local wage setting institutions and employer-employee co-operation less efficient in Finland than in other Nordics (Braconier, 2010). Planned legislative changes to strengthen the employees' position in companies' decision making on issues like pay, working hours, flexible working hours and well-being at work (Prime Minister's Office, 2015) can help pave the way for a "two-tier" collective bargaining framework, in which a central coordination is combined with firm-level flexibility. Wage bargaining in Sweden, Denmark and Norway have long followed such a model, which can secure both macroeconomic coordination and better allocation of labour. Strengthening the mandate of the state mediator in this process could further improve incentives to reach reasonable agreements.

Lengthening the trial period for new hires, loosening restrictions on fixed-term contracts for assignments shorter than a year and easing a requirement to offer employment to earlier laid-off employees, as proposed by the government (Prime Minister's Office, 2015) will make it easier to hire, as it will increase opportunities to test

Figure 14. **Relatively generous unemployment benefits are tapered slowly**[1]



1. Replacement rates are calculated for four family types; single, lone parent, couple and couple with children. Rates are from 2013.

Source: OECD, Tax-Benefit Models.

How to read this figure: The initial net replacement rate refers to benefits received during the first 12 months of unemployment as a percentage of the previous wage. Persistence is calculated as the sum of replacement rates over five years divided by the initial replacement rate. A low value means that the initial benefit is tapered relatively quickly.

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the capabilities of new hires and reduce the risk and cost associated with lay-offs. More should be done to ease regulations on individual dismissals, as they make companies reluctant to hire, notably young and small firms.

Education will be reformed

Adult skills are high in Finland, and school results are good. But the skills of 15-year olds, as measured by the *OECD Programme for International Student Assessment (PISA)*, are declining. Boys are increasingly falling behind girls, and second-generation immigrants do not perform better than the first generation (NAO, 2015). The reasons behind the fall in results are still unknown, but immigrants are too few to account for it. Tertiary education starts late and is completed slowly. Vocational education provides a pathway to work for students who are less inclined to pursue academic studies, but narrow qualifications and

low foundation skills reduce adaptability to structural change. The government will launch programmes to continue professional education for teachers, update pedagogical approaches and use digital learning environments to allow a wider range of learning methods. Training in foreign languages will be stepped up. The government also plans to make vocational education and training more flexible by making it easier to switch between educational paths and easing the financial and administrative burden for apprenticeships (Prime Minister's Office, 2015).

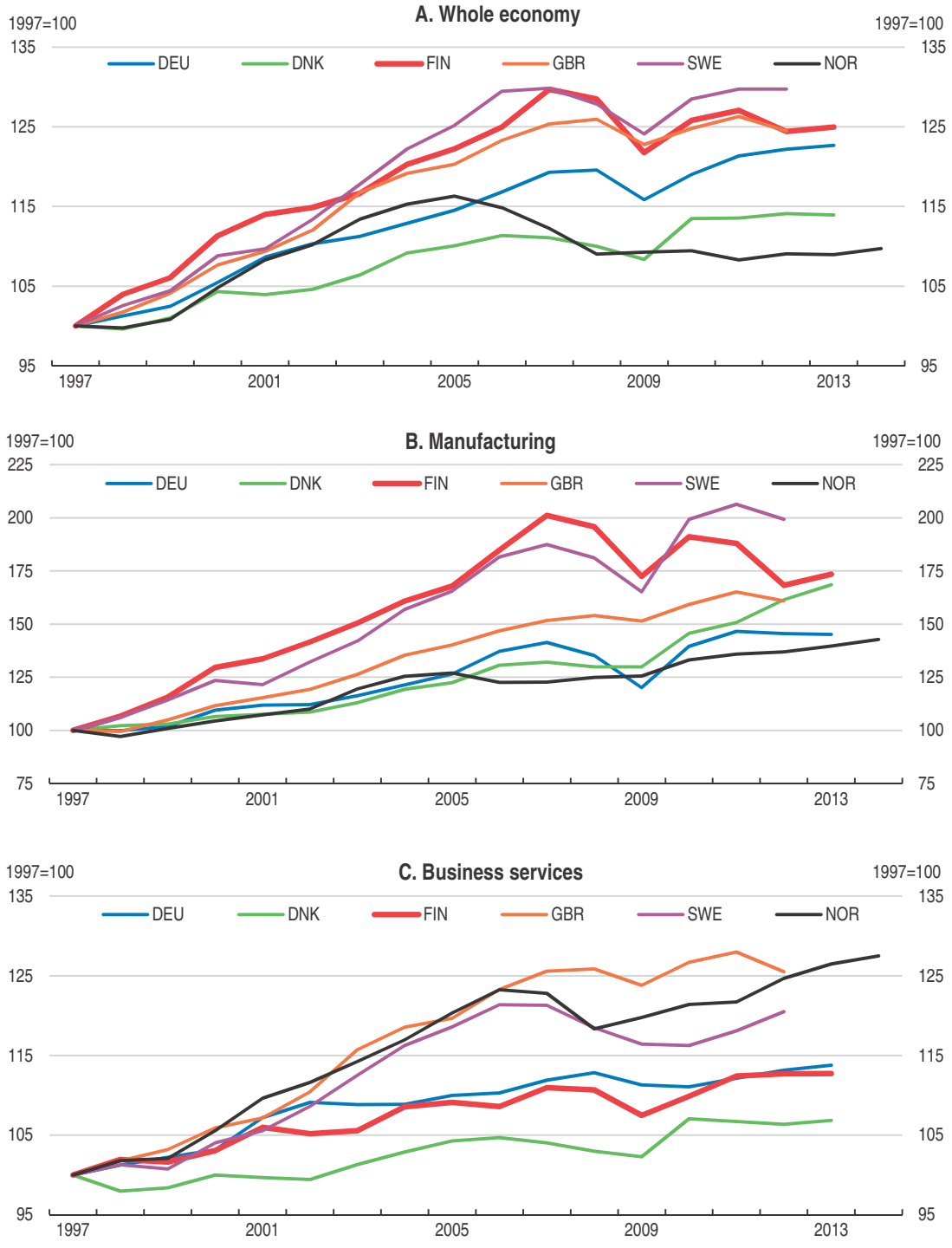
Educational attainment is also high in Finland, but progress has slowed and tertiary education attainment of the young is today below the OECD median. Speeding up entry and graduation would free up resources to accommodate more students. A joint national application to tertiary education will smooth transitions from upper secondary to tertiary education. Plans to reform the system of entrance exams that differ between universities and programmes should contribute further. Long completion times have been discouraged by stepwise reforms to student support and university financing, and the government plans to go further in this direction. Furthermore, the government intends to pave the way for more students entering working life with a Bachelor's degree by adjusting qualification requirements in the public sector (Ministry of Finance, 2014; Prime Minister's Office, 2015).

Regulations will be streamlined

Burdensome regulations and barriers to entrepreneurship can hamper productivity growth, which is the main driver of living standards, well-being and competitiveness in the long run. As shown in the government debt simulations above, an increase in productivity can also markedly improve fiscal sustainability. Finland has experienced a fall in labour productivity since 2007, mainly due to the manufacturing sector, which had performed exceptionally well during the preceding decade (Figure 15, Panels A and B). A shift in the production structure towards less productive sectors, as high-productivity sectors suffered most during the downturn, and perhaps also labour hoarding played a role in the drop in productivity. Business services productivity growth is sluggish, as in Denmark and Germany, but in contrast with the strong performance of Norway, Sweden and the United Kingdom (Panel C). This suggests that there is room for raising business services productivity in Finland, which is all the more important as services and manufacturing are increasingly intertwined (Ministry of Employment and the Economy, 2015).

Finland's product market regulations (PMR) are less restrictive overall than the OECD average (Figure 16, Panel A). Only the Netherlands and the United Kingdom have significantly leaner regulations (Koske et al., 2015). The 2011 Competition Act brought regulation in line with recommendations from the European Commission. It reinforced merger control and enhanced damage compensation as well as "whistle-blowing" instruments. It also expanded the investigation powers of the Finnish Competition Authority, whose resources have been increased. Competition is, however, limited by low population density in large parts of the country. Finnish regulations remain excessively cumbersome in some areas, notably retail trade, network industries, construction and land-use planning. Streamlining regulations is a key objective of the new government, which also plans to promote competition in the construction industry and public services (Prime Minister's Office, 2015). Store opening hours were further liberalised in

Figure 15. **Productivity developments vary widely across sectors**[1]



1. Real output per hour worked.

Source: OECD National Accounts database.

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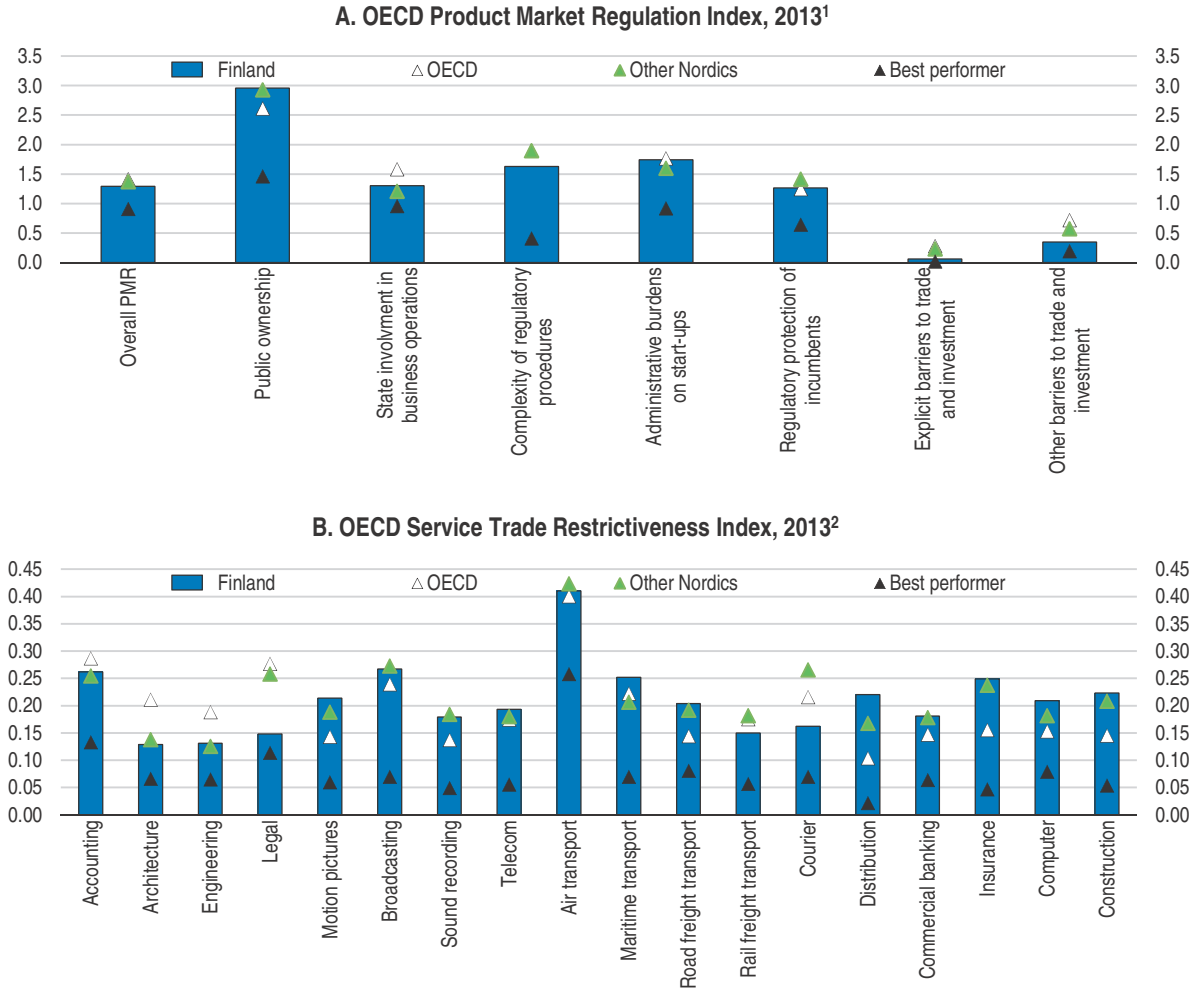
Figure 16. **Product market regulations and service trade restrictiveness could be eased further**



1. Index, scale of 0-6 from least to most restrictive.
2. STRI indices take values from 0 to 1, where 0 is completely open and 1 completely closed.

Source: OECD Product Market Regulation and *Service Trade Restrictiveness Index databases*.

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December 2015. Land-use planning still restricts retail outlets (*OECD Economic Survey of Finland*, 2012), and a proposal to amend the land use and building act submitted to Parliament in late 2014 was judged by the Competition Authority to fail to effectively take into account competition objectives (European Commission, 2015a).

There is scope for greater competition in transport. Indeed, the government is considering opening up rail passenger transport competition. There is some competition for freight, but entry in the freight market remains challenging, given the dominant position of the incumbent in the organisation of the railway system (Mäkitalo, 2011). Road transport accounts for 75% of total freight transport and market entry is relatively tightly regulated. Cabotage – transport inside a country by a foreign haulier – accounts for a much lower share of the market than in Denmark and Sweden (European Commission, 2013). There may also be room to enhance competition in air transport, where the national carrier enjoys a dominant position on many domestic routes.

The government also aims at promoting competition in the construction industry. Indeed, competition may be hampered by concentration and market power of developers and construction firms, as well as by regulatory constraints. Furthermore, the construction product industry – e.g. concrete, paints – is more concentrated than the building industry. Prices lack transparency, as complex discount systems prevail. The market is dominated by a few firms and market entry is unattractive to foreign players because of the small size of the country and specific national standards (André and García, 2012).

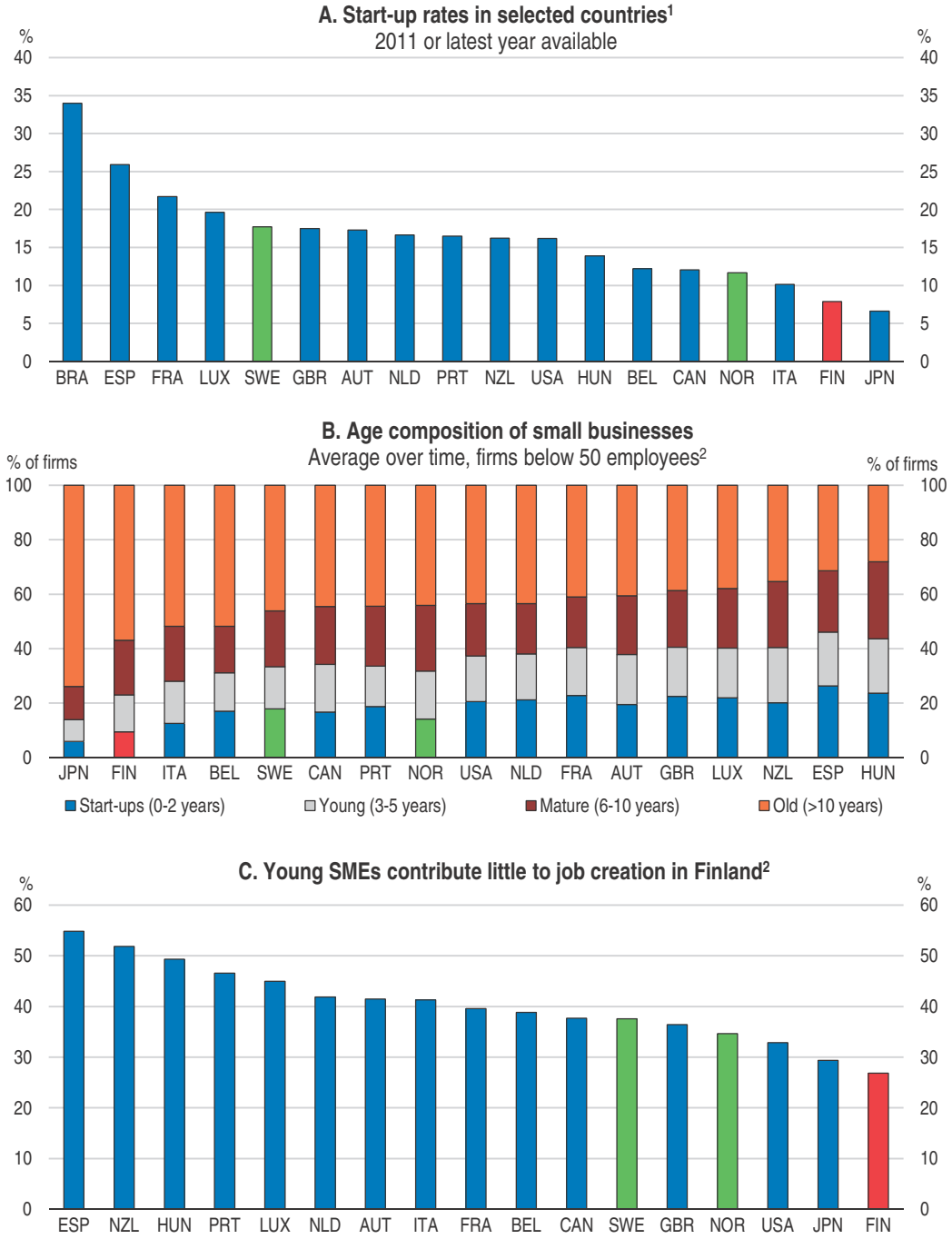
Finland's Service Trade Restrictiveness Index (STRI) scores are above the OECD average and scores of other Nordic countries in several sectors (Figure 16, Panel B). The comparison with the OECD's best performers on these indicators suggests that there is room for lowering barriers further in a number of sectors, including transport and construction, consistent with the PMR indicators.

Entrepreneurship will be promoted

Economic renewal occurs both through the restructuring of old firms and through the emergence and growth of new companies. In OECD countries, young firms provide the main contribution to employment growth (Criscuolo et al., 2014). In Finland, start-up rates have been among the lowest in the OECD, both before and during the downturn (Figure 17, Panel A). The share of young companies among small businesses is among the lowest in the OECD (Figure 17, Panel B). This comes despite low barriers to entry in most markets and a cost of bankruptcy legislation for entrepreneurs which is among the lowest in the OECD (OECD,2015c). Furthermore, young firms' growth has been fairly slow on average. Even though growing is a challenge for small firms in most OECD countries, the contribution of young firms to job creation and employment growth in Finland from 2001 to 2011 was particularly weak (Figure 17, Panel C).

Beyond streamlining regulations, the government plans to support innovation and entrepreneurship in several ways. It is creating special funds to raise equity capital and enhance the risk-taking capacity of businesses, notably start-ups and growth firms. It will strengthen Team Finland, which brings together a range of government-funded organisations to support exporters and promote Finland's brand name. Co-operation between higher education institutions and businesses will be reinforced (Prime Minister's Office, 2015). Higher education is currently fragmented, with many inefficient small research units. Consolidation is necessary to create larger centres of excellence, with a higher profile which would favour integration in international research networks. Collaboration on innovation of both large firms and SMEs with higher education or research institutions is among the strongest in the OECD (OECD, 2015d). This can contribute to diffusing knowledge, promoting innovation and fostering entrepreneurship and should be encouraged further, for example, through putting more weight on funding criteria for higher-education institutions or through R&D vouchers (Research and Innovation Policy Council, 2014). A one-off package of €1.6 billion to fund key projects in 2016-18 will also contribute to encourage innovation, in particular through investments in clean technologies, digitalisation and health.

Figure 17. **Young firms' contribution to growth and jobs is low**



1. Fraction of start-ups among all firms.
2. 2001-11.

Source: Criscuolo, Gal and Menon (2014).

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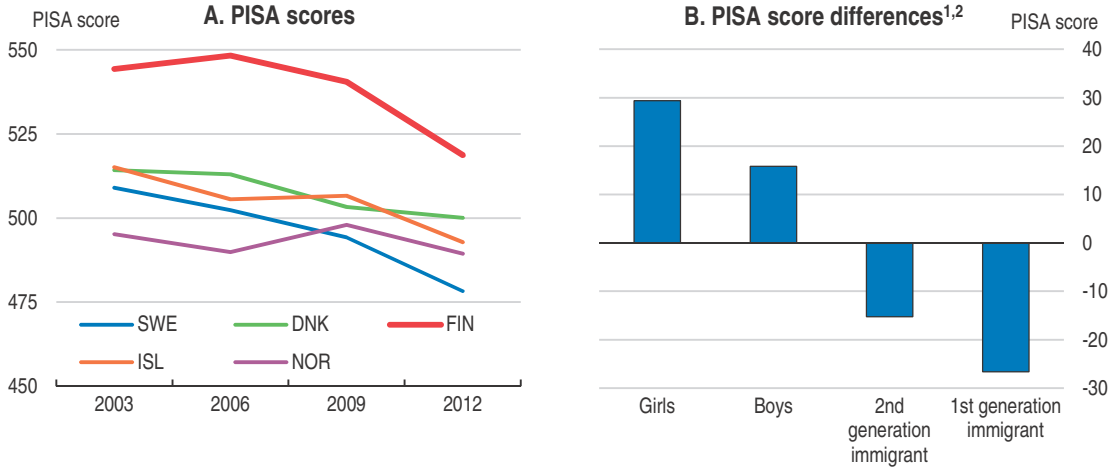
Investing in the future is essential

Raising workers' skills

Finland has one of the highest levels of educational attainment in the OECD. It is renowned for its good results in compulsory schools, which are reflected in high PISA rankings, even though spending per pupil is slightly below the OECD average. However, PISA performance has deteriorated since 2006 (Figure 18, Panel A) and boys fall behind girls. Furthermore, second-generation immigrant youth score lower than natives and only slightly better than first-generation immigrants (Panel B; NAO, 2015). PISA results are also falling in other Nordics. Even though the reasons behind the falling results are not fully understood some hypotheses, such as the effect of rising immigration, can be ruled out. Also, Finland ranks second in the *OECD Survey of Adult Skills* (PIAAC) for literacy, numeracy and problem solving in technology-rich environments (OECD, 2013a).

Figure 18. **Skills are high, but school results are falling**



1. Data refer to 2012.
2. 16-65 year-olds, difference to OECD average.

Source: OECD, *Survey of Adult Skills (2012)*; *PISA 2009* and *PISA 2012 databases*.

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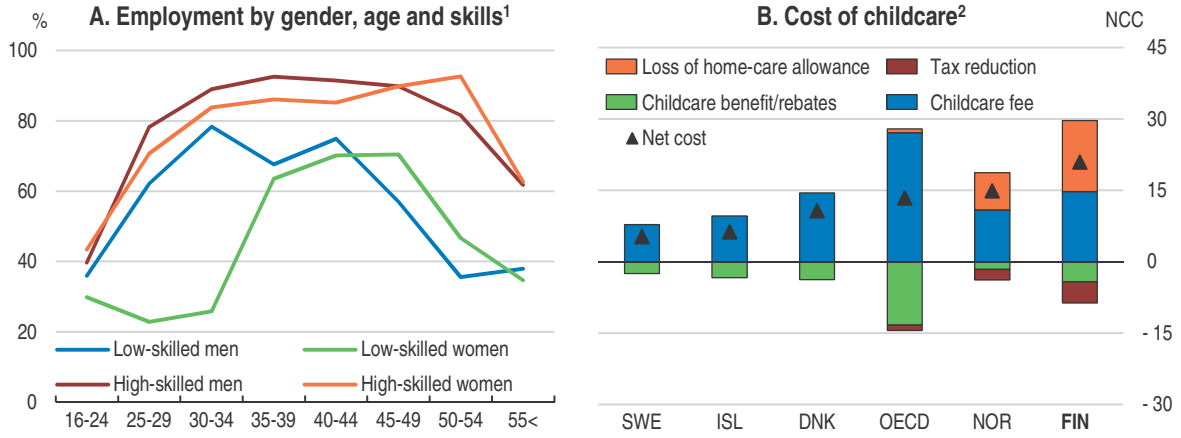
High-quality vocational education and training (VET) eases the transition from school to working life by focusing on trade-specific skills. But lower foundation skills reduce VET graduates' adaptability to rapid technological change (Hanushek et al., 2011). Efforts to build foundation skills should be increased, along with life-long development and training to improve the long-term labour market outcomes of VET graduates. Consolidating VET programmes and specialisations could be considered as a part of this effort.

More research is needed to identify causes of the relatively poor school results for boys and immigrant children and make sure that teaching practices are adjusted accordingly, so that these children are given a fair treatment and the support they need to succeed. Higher enrolment in pre-primary education would lift average educational outcomes and increase equity, but a relatively generous home-care allowance incentivises women to keep their children at home until the youngest sibling turns three.

Encouraging female participation and promoting gender balance

The employment rate of Finnish women (68%) is close to that of men (69%) but considerably lower than in the other Nordics. Despite a second place in the Global Gender Gap Report, only 24% of science, technology, engineering and mathematics students are female. Furthermore, the Finnish labour market is gender-segregated. Just 30% of legislators, senior officials and managers are female, and women are 70% more likely than men to be in part-time work (WEF, 2014), contributing to a gender wage gap of 19% (Eurostat, 2015a). Labour force participation among Finnish mothers with children below six years of age is the lowest in the Nordics, almost 20 percentage points below that of Sweden and Denmark (Eurostat, 2015b). The home-care allowance and the associated supplements reduce work incentives, especially for women with low potential earnings, since it offers a flat rate subsidy for staying at home (Figure 19, Panel A). Indeed, the cost of childcare, taking into account the loss of benefits when working, is the highest among the Nordics (Panel B). Four in ten women with children aged below seven receive the home-care allowance rather than making use of public day-care. Kosonen (2013) finds that increasing the home-care allowance reduces substantially maternal labour supply and earnings. Female employment rates across the OECD fall sharply if combined parental- and home-care leave entitlements exceed two years (Thévenon and Solaz, 2013). A study of Swedish women shows that women taking 16 months leave or more are less likely to progress in their careers once back on the job again (Evertsson and Duvander, 2011). Lower participation and earnings imply lower pensions. Limiting the combined duration of parental leave and the home-care allowance to between one and two years would generate significant gains in children's enrolment and mothers' employment. Simulations for Austria show how moving towards a more gender-equal working life could yield substantial growth and well-being gains (OECD, 2015e).

Figure 19. **The home-care allowance reduces female employment**



1. Low skills are defined as PIAAC level 2 or lower in literacy. Data were collected in 2012.
2. Calculated for the year 2012 as the difference in family net income of a double-earner family with two children, aged two and three, who uses centre-based childcare and an otherwise identical family who does not. Family net income is the sum of gross earnings plus cash benefits minus income taxes and social contributions paid by workers for a family with two earners, earning 67% and 50% of the national average wage, respectively.

Source: *OECD Survey of Adult Skills*, 2012, OECD Tax-Benefit Models, *www.oecd.org/els/social/workincentives* (last accessed 27 July 2015).

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Promoting work immigration

Immigration could partly compensate for Finland's declining workforce as its population ages. Only 5% of the population is foreign born and gross inflows have averaged 0.3% annually in recent years, of which half is work immigration, almost exclusively from other EU countries. The nature of immigration has a strong bearing on labour market performance. Immigrants from OECD countries are largely work immigrants, who are generally skilled and perform well in the labour market (Pareliussen, 2016). Finland should encourage more work immigration by abolishing the "work test" that stipulates that non-EU work immigrants can only immigrate if their job offer is in an occupation where there is a lack of local supply, by improving systems for recognition of foreign qualifications and by bridging courses, and streamlining systems to integrate workers' families.

Immigrants from poorer countries, who often come for humanitarian reasons or family reunion, tend to have weaker socio-economic backgrounds, to be less educated and to score lower on literacy tests (Pareliussen, 2016). As a result, they are less likely to be employed, more likely to be overqualified for their jobs, more likely to be poor, and more likely to live in overcrowded accommodation (OECD/European Union, 2015). The number of asylum seekers has surged in 2015, notably from Iraq, Somalia and Afghanistan. Tapping this potential to reinvigorate Finland's ageing workforce depends on effective integration policies in which up-skilling, starting with language, is the cornerstone. Experience from Canada and Switzerland shows that utilising immigrants' full skills is a challenge, but that well-developed apprenticeship schemes help integration of low-skilled immigrants and their children (OECD, 2013b; OECD, 2014c). Finland does fairly well in the up-skilling of first generation immigrants. Even though the literacy proficiency of newly arrived immigrants is low, it exceeds the OECD average for foreign-born adults who have lived more than five years in the country (Bussi and Pareliussen, 2015). However, the magnitude of current inflows is unprecedented in Finnish history, and scaling up the integration apparatus while maintaining high quality will be a challenge.

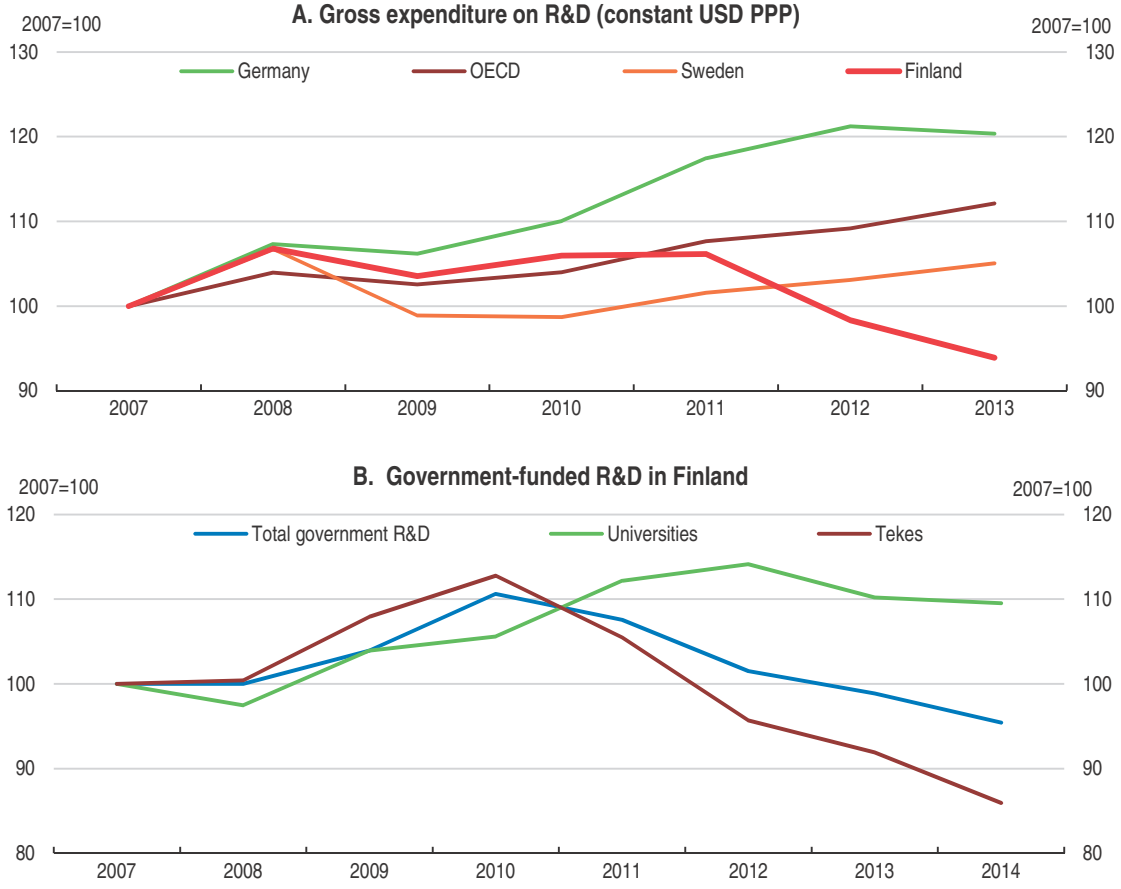
Continuing to support R&D

Finland's government provides broad-based support for innovation, through education and basic research as well as through help for business innovators, including funding, counselling, network building and international promotion. Public support for innovation is justified by externalities generated by spill-overs from innovation investment, which raise the social rate of return above the private rate of return, leading to socially sub-optimal investment in the absence of government intervention. Hence, innovation policy should focus on the areas generating the strongest externalities, in particular education and basic R&D (Westmore, 2013). Government support played a key role in the development of the ICT industry over the past decades. But in other sectors results appear mixed, although evaluating innovation policies is fraught with difficulties and requires a long time perspective. Some public support programmes seem to have crowded in private funding for R&D (Einiö, 2009). However, there is also evidence that large firms are more likely to apply for support than smaller ones and that many companies tend to benefit from public support programmes for extended periods (Koski and Tuuli, 2010). Karhunen (2015) finds no significant effect of R&D subsidies on the labour productivity of Finnish SMEs over the five-year period after a subsidy is granted. This may suggest some inefficiencies and deadweight costs.

Innovation is essential to restore Finland's competitiveness. According to the Innovation Union Scoreboard, which provides a multi-dimension comparative assessment of EU countries' research and innovation performances, Finland is among the innovation leaders, along with Denmark, Germany and Sweden, even though its performance has declined somewhat since 2012 (European Commission, 2015b). Business and government R&D expenditures are among the highest in the OECD as a share of GDP. However, Finland's R&D expenditure has declined markedly in real terms after 2011, which contrasts with a pick-up in Germany, Sweden and the OECD as a whole (Figure 20, Panel A). This is a cause for concern in a knowledge-based economy. To a large extent, the contraction in R&D reflects the difficulties of the ICT sector, where R&D is highly concentrated. The low level of R&D and patents in non-ICT sectors is one of the main weaknesses of the Finnish innovation system, and is reflected in the inability of other industries to compensate the decline in ICT output.

Direct government R&D funding declined by about 14% in real terms between 2010 and 2014 (Figure 20, Panel B). Further cuts are planned over the current parliamentary term. The overall budget for tertiary education will be cut by about 4% and the budget of the Finnish funding agency for technology and innovation (Tekes), which already shrank by about a quarter in real terms since 2010, will be reduced further by about a third (Prime Minister's Office, 2015). There is indeed scope for efficiency gains. A large number of

Figure 20. **Business and government R&D is being scaled down**



Source: OECD, Main Science and Technology Indicators database and Statistics Finland.

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government agencies are involved in funding business innovation and development and efficiency gains could be achieved through rationalisation (*OECD Economic Survey of Finland, 2012*). As well, substantial efficiency gains could be realised by reorganising higher education. Furthermore, part of Tekes financing could be replaced by private funding. Even so, R&D spending is likely to be affected by the spending cuts, which could affect Finland's growth potential.

Although credit standards for SMEs have been tightened somewhat, access to finance has remained easy compared to most other European countries since the 2008 financial crisis (OECD, 2015f). Furthermore, innovative firms can benefit from substantial public funding. However, as the latter is being scaled back, other funding sources will need to be found. The government has committed to raising additional capital for business financing, based on market needs. However, Finland could also take greater advantage of new forms of SME and entrepreneurship finance which are emerging globally, including asset-based lending, alternative forms of debt, crowdfunding and hybrid instruments. Such instruments are often better suited than traditional bank lending to innovative and fast-growing companies and could contribute to financing innovation in Finland. The conditions for the expansion of alternative financial instruments, in particular in terms of regulatory framework, should be explored, paying attention to striking a balance between financial stability, investor protection and the opening of new financing channels for SMEs (OECD, 2015g).

Public procurement can also be used to encourage innovation, without compromising the essential requirement to maximise value-for-money. Fostering demand for innovative products is an important dimension of innovation policy, as uncertainty about demand may deter firms from developing some innovations and investors from funding them. As public procurement amounts to nearly a fifth of GDP in Finland (OECD, 2015h), having innovation requirements where applicable can make a difference. The government has set an objective of 5% of innovative public procurement (Prime Minister's Office, 2015). Finland has been encouraging environmental sustainability in public procurement since 2009 (Ministry of the Environment, 2009). In addition, many municipalities have engaged in innovative procurement, especially in construction, social and health care services and energy and water supply, in some cases supported by funding from Tekes' Smart procurement programme. Nevertheless, there may be room for requiring more innovation from firms responding to public procurement in many areas. This is particularly the case in sectors where public procurement represents a substantial share of the market, like health care, education, transport or construction.

Getting value for money requires a competitive tendering process and fostering innovation calls for a focus on the functionalities of procured items rather than on technical specifications. Importantly, effective procurement requires expertise on the part of the purchaser and evaluating the outcomes of innovative procurement is often complex. In Finland, local authorities are responsible for a large share of public procurement and may have difficulties in building up the required expertise. This difficulty may be overcome through exchange of information across government authorities, standardisation of procurement procedures or centralisation of procurement (OECD, 2014d). The proposed social and health care reform foresees that one national unit would take care of all health care related public procurement, with a view to improve the efficiency of public procurement in this sector. Moreover, health care ICT is to be centralised.

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