

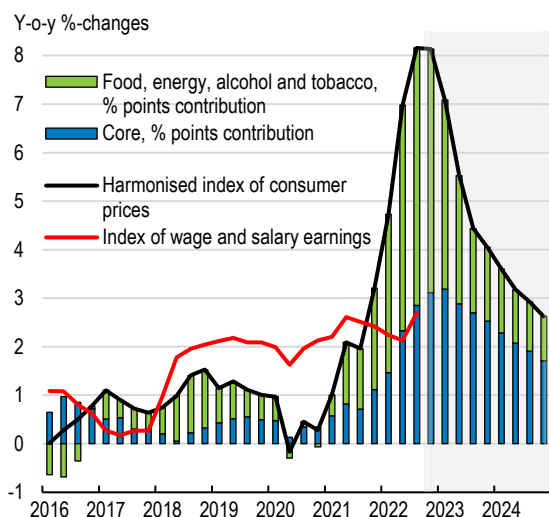
Executive summary

The economy recovered from the COVID-19 shock but now faces deteriorating global conditions

Finland recovered rapidly from the COVID-19 shock but growth stalled following Russia's war of aggression against Ukraine. Soaring inflation has reduced household disposable income in Finland and its trading partners, slowing the economy. Finland has been able to replace most of the lost Russian energy supplies.

Output had returned to the pre-COVID-19 level by the second quarter of 2021 and the output gap to the pre-pandemic level by the first quarter of 2022. A new upsurge in serious COVID-19 cases had only minor economic effects and receded quickly.

Figure 1. Inflation has soared



Source: Statistics Finland; OECD (2022) [Economic Outlook](#) (database).

StatLink  <https://stat.link/lf9u5h>

Following Finland's application in May 2022 to join NATO, Russia terminated gas and electricity exports to Finland. While most gas was imported from Russia, gas only represents 5% of total energy consumption and plans are advanced for sourcing most of it elsewhere, in LNG form. Nevertheless, replacing gas in industrial uses is proving more difficult. The new nuclear power plant will supply 14% of Finland's electricity when it reaches normal production this winter, more than compensating for lost Russian electricity imports.

Russia's war of aggression against Ukraine accentuated increases in energy prices that began in late 2021, pushing up inflation to 8.2% by the third quarter both directly and indirectly as higher energy

and food prices fed into core inflation (Figure 1). Wage increases have lagged far behind inflation, reducing household real disposable income and portending future weakness in private consumption expenditure.

Finland enjoyed a strong labour market recovery from the COVID-19 shock until the second quarter of 2022. The employment and unemployment rates regained pre-pandemic levels by mid-2021 and early 2022, respectively, and have now posted their best performances since 1987 and 2008, respectively. Labour market tightness has increased markedly and the job vacancy rate is now higher for any given unemployment rate than in the past. Given the fast recovery and rapid increase in employment, part of the mismatch may be temporary, reflecting rigidities in filling jobs. Nevertheless, shortages in non-cyclical professions, such as healthcare and long-term care, are the most pronounced and are likely to persist. Reducing such mismatches requires training of workers and/or relaxation of skill requirements in jobs as well as stronger incentives for workers, unions and firms to compromise to improve match acceptance rates.

To rein in inflation, the European Central Bank has begun tightening monetary policy and is expected to continue doing so through 2023. Fiscal policy in Finland became expansionary in 2022 largely owing to expenditures related to Russia's war in Ukraine and will be again in 2023 but will be neutral in 2024.

The economy will stall in 2023 but growth will recover to 1.1% in 2024. Consumption will weaken in response to falling real wages but subsequently recover as wages rise. Export growth will decline with export markets, which are being hit by the reduction in gas supplies from Russia, but will pick up as alternative energy sources are found. Business investment will remain weak through 2023 owing to the economic downturn and more uncertain economic outlook caused by Russia's war in Ukraine but strengthen in 2024 as the global outlook improves. The unemployment rate should peak at around 8% and only fall slightly by end-2024. Inflation will fall to 3.1% in 2024, when the energy shock will have passed.

The downturn would be deeper if Russia were soon to cut off gas supplies to more EU countries, thereby preventing the rebuilding of gas stocks during summer 2023. Another downside risk is that tightening global

financial conditions could affect the housing market and consumption and investment more than foreseen.

Table 1. Economic growth will slow
(Annual growth rates, %, unless specified)

	2021	2022	2023	2024
Gross domestic product	3.0	2.2	-0.3	1.1
Private consumption	3.7	2.3	-0.6	1.4
Gross fixed capital formation	1.5	3.0	-0.7	0.2
Exports	5.4	-0.5	1.9	3.1
Imports	6.0	9.0	1.2	2.3
Unemployment rate (%)	7.6	7.0	7.9	7.8
Harmonised index of consumer prices	2.1	7.0	5.3	3.1
Current account balance (% of GDP)	0.6	-2.6	-2.2	-1.9
Government fiscal balance (% of GDP)	-2.7	-2.5	-3.9	-3.6
Government gross debt (% of GDP)	85.0	84.9	87.2	88.8

Source: OECD (2022), [Economic Outlook](#) (database).

Macroprudential policies are strengthening financial stability

Finnish financial institutions' greatest vulnerability is too high household debt. The authorities have taken steps to limit the risk it poses to financial institutions but more needs to be done. Exposures to Russia are minor.

Household debt is 150% of disposable income, mostly for housing loans. Households are vulnerable to rising housing loan interest rates as they are typically revised annually.

To curb rising household indebtedness, the Board of the Finnish Financial Supervisory Authority (FIN-FSA) has returned loan-to-value restrictions to the pre-pandemic level and issued a recommendation on a debt servicing-to-income limit for mortgage lending. The Government has put forward a proposal to limit the maximum maturity of housing loans and housing company loans to 30 years, reduce the maximum amount housing companies can borrow for new construction and require amortisation of such loans to begin during the first five years. However, it has not given the FIN-FSA power to impose debt-servicing-to-income restrictions, out of concern about the effects on first-home buyers.

Fiscal consolidation is needed to stabilise debt

On current policies, the structural budget balance would need to rise by 2.5% of GDP for the debt-to-GDP ratio to stabilise. Age-related expenditures are projected to rise by 4.5% of GDP by 2070, driven by health and long-term care. Pension- and

labour market reforms limit the projected increase in pension expenditures.

The government is committed to reducing the structural budget deficit mainly by increasing employment. The Ministry of Finance estimates that the employment measures taken to date or at an advanced stage could increase employment by 40 000 and reduce the structural deficit by 0.2% of GDP, far short of what is needed to stabilise the debt-to-GDP ratio. Closing the unemployment tunnel route to early retirement makes a large contribution to these gains but there is a risk of leakages into the disability benefit route.

On unchanged policies, the OECD projects that gross general government debt as a share of GDP will increase from 72% in 2021 to 131% in 2070. Reform fostering work-based immigration and improvements in the innovation system could limit the increase, with debt rising less, to 114% of GDP.

The health- and social-care reform, which transfers responsibilities for the delivery of health and social services from municipalities to counties, is expected to yield improvements in efficiency and slow growth in health and long-term care costs in the long run. However, there is a risk that the steering and financing model does not lead to more efficient outcomes as the new organisations have weak incentives to implement measures that would lead to efficiency gains.

Regular, comprehensive expenditure reviews, as in the Netherlands, could help to identify consolidation measures. In this context, there may well be scope to reduce aid and tax expenditures to companies that do not boost long-term productivity and to replace reduced VAT rates by more targeted measures.

Reforms to strengthen innovation would increase productivity growth

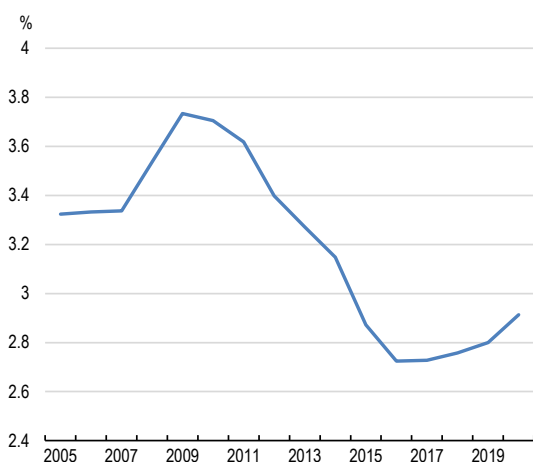
Productivity slowed down considerably during the 2010s, due to weaker innovation, less efficient resource allocation and less capital deepening. Additional reforms are needed to reboot the innovation ecosystems and strengthen productivity growth.

The government aims to boost Finland's gross domestic R&D spending to 4% of GDP by 2030 (Figure 2) and will introduce legislation that authorises an increase in government R&D spending to 1.2% of GDP by 2030. The revamped innovation support should continue to provide ample support to

basic research while directing applied research toward solving the most pressing socio-economic challenges through a mission-oriented innovation policy framework. At present, innovation support lacks clear orientation and is spread across numerous measures. Coordination of innovation activities between public and private sectors as well as among various innovation actors has weakened, holding back more effective innovation collaborations between firms, higher education institutions and research institutions.

Figure 2. Spending on innovation weakened during the 2010s

Gross domestic R&D spending, % of GDP



Source: OECD, Main Science and Technology Indicators ([database](#)).

StatLink  <https://stat.link/xk0bfl>

The government will introduce a new R&D tax allowance to stimulate stronger business-based R&D spending. Finland's previous R&D tax incentives have not been taken up by many firms due to the narrow scope of eligible activities. They were also not well targeted to smaller firms that respond most to tax incentives.

Despite a favourable business environment, more can be done to enhance investment and improve resource allocation. For instance, stringent employment protection and wide coverage of collective wage agreements with limited opt-outs discourage innovative firms from scaling up by hiring more people and investing.

Severe skills shortages are a major bottleneck to more intensive investment and innovation activities. The government has implemented a university admission

reform to improve the allocation of university places and accelerate the transition to tertiary education but has neither increased flexibility by field of study to address acute skills shortages nor committed to funding the increase in places needed to achieve its tertiary education attainment target.

Reforms are needed to reduce greenhouse gas emissions efficiently

Finland is broadly on track to meet its gross greenhouse gas abatement targets for 2030 and 2035 but not the forestry and other land-use targets. There is scope to increase the efficiency of abatement measures.

The marginal abatement cost of the national biofuel mandate, which contributes to meeting the EU effort-sharing target, is estimated to be EUR 500 per tonne of CO₂-eq. and the annual cost of the mandate to the national economy to be EUR 1.1 billion, rising to EUR 1.5 billion by 2030. The carbon price used to calculate carbon tax rates on heating fuels is lower than for transport fuels and peat is subject to a lower tax rate for heat production than other fossil fuels. Abatement costs could be reduced by eliminating these tax differences. Measures to reduce car dependency in cities, such as improving public transport in the capital region, and to support the diffusion of low-carbon vehicles in other localities would also contribute to cost-efficient abatement

Net emissions from the forestry and other land-use sector need to fall from 2 Mt CO₂-eq. currently to minus 17 Mt CO₂-eq. in 2030 and minus 21 Mt CO₂-eq. in 2035 to meet Finland's share of the EU target for this sector and the net zero target stipulated in the Climate Change Act, respectively. There is considerable scope to increase this sector's net sink role by reducing emissions from peatland cultivation (8Mt CO₂-eq.). This could be done by creating instruments to guide the cultivation of peatlands towards paludiculture (*i.e.*, cultivation of wetted peatlands), as in Sweden, or allowing these lands to revert to a wooded state. Subjecting forestry to carbon pricing, as in New Zealand where the sector is included in the New Zealand Emissions Trading Scheme, would also help to increase the forestry and other land-use net sink.

MAIN FINDINGS	KEY RECOMMENDATIONS
Ensuring fiscal sustainability and financial stability	
The fiscal stance became expansionary in 2022 largely owing to Russia's war against Ukraine and will be again in 2023 but will be neutral in 2024. Increases in energy and food prices have put pressure on budgets of households not receiving social-security benefits, which are indexed to inflation.	Provide targeted assistance to vulnerable households not deriving their income from social-security benefits while ensuring that the structural budget position does not deteriorate unless the outlook materially worsens.
The Ministry of Finance estimates that the fiscal sustainability gap and the structural budget deficit in 2026 will be 3.0% and 2.4% of potential GDP, respectively. Fiscal buffers to cope flexibly with adverse shocks are diminished. Almost half of state aid to companies does not directly promote productivity.	Implement consolidation measures to achieve Finland's medium-term structural budget deficit objective (0.5% of GDP) by the end of the decade. Undertake a comprehensive spending review to identify consolidation measures and make such reviews regular. Reduce state aid to companies that does not enhance productivity.
The healthcare and social-care reform is expected to reduce growth in expenditures in the long run and to deliver better services across the country. There is a risk, however, that incentives are too weak for the new counties to increase efficiency.	Monitor the healthcare and social-care reform and strengthen incentives to increase efficiency if they prove to be too weak.
Interest rates on most housing loans are revised annually. Highly indebted households may have difficulty servicing debts when interest rates rise to more normal levels.	Empower the Board of the Finnish Financial Supervisory Authority (FIN-FSA) to impose debt-service-to-income limits on mortgage lending.
Boosting productivity and innovation and increasing employment	
The government will introduce an R&D tax incentive with an upper limit, making it insignificant for large companies.	When sufficient data are available, evaluate the effects of the R&D tax incentive and adjust it accordingly.
Chronic shortages of study places in higher education institutions are resulting in high rejection rates and low tertiary educational attainment among young adults. These in turn contribute importantly to the severe skills shortage that constrains innovation.	Commit to a credible plan to increase study places in universities and universities of applied sciences and funding for additional study places while enhancing flexibility in the allocation of study places across study fields to address structural skills shortages.
The employment rate of migrants with high educational attainment is low. The employment and career prospects of foreign highly skilled workers in Finland are worse than in many other OECD countries.	Promote the recognition of qualifications held by foreign skilled workers and provide effective training to fill the gap between their qualifications and the skills required at their workplace.
Firms that are not members of the employer association that negotiated the sectoral wage agreement are by law forbidden from using the enterprise-bargaining flexibility clauses. This weighs on the productivity and profits of these mostly small firms.	To support employment and productivity, high-level agreements should set broad framework conditions in wage bargaining but allow for more flexibility in all firm-level contracts.
To realise the employment potential of phasing out extended unemployment benefit (the unemployment tunnel to early retirement), it will be important to limit early retirement leakage into disability benefit.	No longer take non-medical factors for the award of disability benefits into consideration for applicants aged 60 or over, as for other applicants.
The generous homecare allowance discourages work by mothers with young children. Long absences from the labour force negatively affect their career prospects and earnings mobility.	Reduce the homecare allowance to increase incentives for mothers of young children to work.
Reducing greenhouse gas emissions efficiently	
The marginal abatement cost of the national renewable fuel blending (i.e., biofuel) distribution mandate is high (EUR 500 per tonne of CO ₂ eq.). The carbon price used to calculate carbon tax rates on heating fuels is lower than for transport fuels, increasing abatement costs.	Reduce the share of biofuels mandated to the minimum level required by the European Union. To compensate, align the carbon price used to calculate carbon tax rates on heating fuels with that used for transport fuels and, if necessary, increase this carbon price. Alleviate the burden of the energy transition on vulnerable households not compensated by social benefit indexation.
Heat production is subject to a much lower tax rate when using peat than when using other fossil fuels. Carbon emissions from peat-fired power plants are greater than from coal-fired power plants.	Subject heat production using peat to the same tax regime as for other fossil fuels. Announce a clear phase-out date for peat extraction to provide certainty for stakeholders.
The marginal abatement cost of electric vehicles is elevated (almost EUR 300 per tonne of CO ₂ eq.), albeit declining quickly. Car dependency in cities remains high.	Strengthen policies to reverse car dependency in cities, including enhanced provision of public transport in the capital region, while focusing funding for low-carbon private cars in other localities.
Further measures are needed to increase the forestry and other land use net sink to meet Finland's share of the 2030 EU target for this sector and to achieve the net zero emissions target by 2035.	Create instruments to guide the cultivation of peatlands towards paludiculture (i.e., cultivation of wetted peatlands). Subject forestry to carbon pricing.



From:
OECD Economic Surveys: Finland 2022

Access the complete publication at:

<https://doi.org/10.1787/516252a7-en>

Please cite this chapter as:

OECD (2023), "Executive summary", in *OECD Economic Surveys: Finland 2022*, OECD Publishing, Paris.

DOI: <https://doi.org/10.1787/1bccfc5f-en>

This work is published under the responsibility of the Secretary-General of the OECD. The opinions expressed and arguments employed herein do not necessarily reflect the official views of OECD member countries.

This document, as well as any data and map included herein, are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area. Extracts from publications may be subject to additional disclaimers, which are set out in the complete version of the publication, available at the link provided.

The use of this work, whether digital or print, is governed by the Terms and Conditions to be found at <http://www.oecd.org/termsandconditions>.