## Finland— Summary of the Concluding Statement for the 2015 Article IV Consultation

*Finland's economy has been in a recession for three years, owing to a unique confluence of cyclical and structural shocks. Reviving activity by boosting productivity and raising labor participation is Finland's central challenge. This requires comprehensive structural reform, including to the wage bargaining system, unemployment insurance, and active labor market programs. Meanwhile, fiscal policy should strike a balance between needed consolidation and protecting the recovery.*

**Following a deep slump, the projected pace of the recovery is modest.** GDP is forecast to increase 0.4 percent in 2015, partly driven by private consumption as low inflation and mortgage amortization holidays support households' purchasing power. Growth is projected to rise to 0.9 percent in 2016, mainly driven by investments in the paper industry. Disappointing growth in trade partners, unexpected financial shocks, or a larger than anticipated impact of fiscal consolidation could derail the recovery. Absent further structural reforms, medium-term growth is set to be much slower than pre-crisis.

**The new government's comprehensive structural reform plan promises to boost growth, but needs to be further developed and implemented**. Last year's agreement on pension reforms will help slow the decline in labor supply and address the long-run fiscal sustainability gap. The recent proposal to parliament to liberalize shop hours is a welcome concrete step and could have an immediate positive effect on employment and output. Recent plans to reduce the labor tax wedge, overtime pay, and paid leave days will help improve competitiveness but do not obviate the need for a more comprehensive approach to labor market reform. Such reforms remain to be fully developed.

**The mission highlighted a few priority reform areas**. The centralized collective bargaining system compresses the wage distribution and constrains firms' ability to adjust wages in line with firm-specific productivity developments. This reduces incentives for labor to be employed in higher-productivity activities and hampers needed adjustment. It also results in a relatively high minimum wage that reduces demand for low-skilled labor, raising structural unemployment. To increase participation and strengthen work incentives, unemployment benefits should be reformed, including by limiting benefit duration and improving monitoring. Some of the savings from such reforms could be used to strengthen active labor market programs, including through earlier and expanded enrollment. Given rising unemployment, the government's plan to cut ALMP spending is therefore a concern. Increasing the availability of affordable housing in growing areas would facilitate labor mobility from regions with high unemployment. More financing for R&D, including well-designed tax incentives, could boost innovation and productivity.

**Making the pace and composition of fiscal consolidation as growth friendly as feasible would support the recovery.** Fiscal consolidation is needed to ensure long-run sustainability and respect European rules, but poses risks to short-term growth. In this regard, fiscal adjustment should focus primarily on addressing long-term pressures, such as through the envisaged reform of health and social services. Cuts to infrastructure projects that address well-identified needs and raise potential growth should be avoided. The earned income tax credit increase in 2016 should help support consumption. Delaying the planned hike in unemployment insurance contributions would avoid raising labor costs when labor demand is weak. The envisaged "growth package" should be frontloaded to the extent possible, thus supporting growth when it is most needed.

**Financial stability risks appear contained but ensuring that robust frameworks exist to deal with future shocks is important.** Banks are profitable and well capitalized. Household credit and house price growth have slowed, and house prices appear broadly in line with fundamentals. Last year's Act on Credit Institutions established a macroprudential policy framework and introduced associated policy tools. There remains scope to further strengthen the framework, especially by adding a systemic risk buffer. Regional cooperation on financial stability issues should also be enhanced.