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GRAY/22/270

January 24, 2022

**Statement by Mr. Hosseini and Mr. Belhaj on Finland
(Preliminary)
Executive Board Meeting
January 26, 2022**

We thank staff for the insightful reports and Mr. Pösö and Mr. Kraavik for their helpful Buff Statement. Finland's pandemic containment and mitigation strategies are commendable. Strong policy measures centered on supporting households and businesses during the pandemic helped Finland weather the crisis with minimal socio-economic damage and enabled a quick rebound in 2021. We welcome the overall positive short-term outlook and note with satisfaction that the output gap is expected to close in 2022 and that the pandemic related scarring is likely to be minor. We also note the risks to this outlook, as well as the structural challenges facing the Finnish economy in the medium term, notably those related to demographic changes and declining productivity that constrain potential output growth. **We broadly agree with staff's assessment and would like to make the following comments.**

Fiscal Policy

In the short term, we agree that, given the uncertainty, fiscal policy should remain prudent and focus on securing the conditions to sustain a sound recovery. The unwinding of the COVID-related measures should be gradual in line with pandemic dynamics. Over the medium term, we note the moderate increase in the structural primary deficit and growing public debt. While this mainly reflects quality and growth-enhancing spending, the relatively long-time horizon for reaping the economic and social dividends suggests a cautious approach to public debt, especially given contingent liability risks arising from the sizeable government guarantees, notably those related to export financing and state housing. We are comforted that reforms to employment benefits and social and health services would contribute to curtailing current spending, and if these measures prove insufficient to contain the deficit, we believe that the authorities have ample room to mobilize additional resources

including through tax measures. To enhance fiscal credibility, we encourage the authorities to consider reverting to the pre pandemic spending limits system or implementing alternative fiscal rules.

Macprudential and Financial Policies

The Finnish financial system is sound, and we positively note that the pandemic has not put major strain on the balance sheets of corporates and households. At the same time, we also note the persistent structural vulnerabilities in the banking sector, including from exposure to the real estate sector, and AML/CFT vulnerabilities related to increased digitalization. We recommend close monitoring of the growing household indebtedness and the credit quality in the corporate sector and welcome further efforts to ramp up the macroprudential toolkit. To this end, we encourage the authorities to return to the pre-pandemic structural buffer requirements and to reassess the cost-benefit of income-related borrower-based measures as soon as the new credit registry is operational.

Structural Policies

We welcome the government's emphasis on R&D, but also stress that public spending should be effective and aimed at promoting marketable innovation and increasing job opportunities. We believe that private sector participation in these efforts is key to better matching investments to market needs. Also, we encourage cross-cutting reforms to improve potential output and labor productivity, notably reform and modernization of education and training and greater flexibility in wage bargaining that would help to address regional and skill mismatches and reduce labor shortages. Proactive measures to integrate immigrants into the workforce can also contribute to address short-term challenges in the labor market.

Climate Change

The strong commitment of Finland to environmental and climate issues is remarkable. We welcome the ambitious goal of achieving net-zero carbon emissions by 2035. We note the myriad of challenges that Finland is facing in addressing climate change issues. The carbon tax has limits, as the authorities have rightly pointed out, and carries risks of carbon leakage from unilateral actions. The discussion on climate policies in this report shows the complexity of the issues, even for a highly committed advanced economy, and underscores the need for a multilateral approach towards an effective climate change policy.

With this, we wish the Finnish authorities and people every success.