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Finland: 2002 Article IV Consultation—Staff Report and Public Information Notice on the Executive Board Consideration

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2002 Article IV consultation with Finland, the following documents have been released and are included in this package:

- the staff report for the 2002 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **June 10, 2002,** with the officials of Finland on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on July 29, 2002.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its August 13, 2002** consideration of the staff report that concluded the Article IV consultation.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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FINLAND

Staff Report for the 2002 Article IV Consultation

Prepared by the Staff Representatives
for the 2002 Consultation with Finland

Approved by Carlo Cottarelli and Martin J. Fetherston

July 29, 2002

- The 2002 Article IV consultation discussions were held in Helsinki during May 30–June 10, 2002. The mission met with: the Governor of the Bank of Finland; the Minister of Finance; officials from the Bank of Finland and the Ministries of Finance, Labor, Social Affairs and Health, and Trade and Industry; members of Parliament's Finance Committee; representatives of labor unions, employers' organizations, research institutes; and the academic community. The authorities published the mission's concluding remarks, organized a press conference and other press coverage, and plan to publish this staff report.

- The mission comprised Mr. Feldman (head), Mr. Berger, and Ms. Wagner (all EU1). Mr. Isleifsson, Executive Director for Finland, also participated in the meetings.

- Finland has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions (Appendix I). It subscribes to, and is in observance of, the Special Data Dissemination Standard, and provides high-quality data, adequate for effective surveillance (Appendix II).

- The government coalition, led by Mr. Lipponen (Social Democrat), faces parliamentary elections in March 2003.

- In concluding the last Article IV consultation on November 9, 2001, Directors commended the Finnish authorities for their sound macroeconomic policies and emphasized that policy responses to the worsening short-term outlook needed to be framed in the context of long-term challenges. In particular, in view of rapid population aging, they strongly supported the government's goal of a significant and durable increase in the employment rate through a comprehensive set of reforms to stimulate employment creation, including further reductions in the heavy tax burden on labor and reforms of the benefits, wage, and pension systems. To leave room for tax cuts on labor, while maintaining sufficiently large fiscal surpluses in preparation for the demographic shock, Directors emphasized the need for ongoing expenditure restraint.

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I. Background

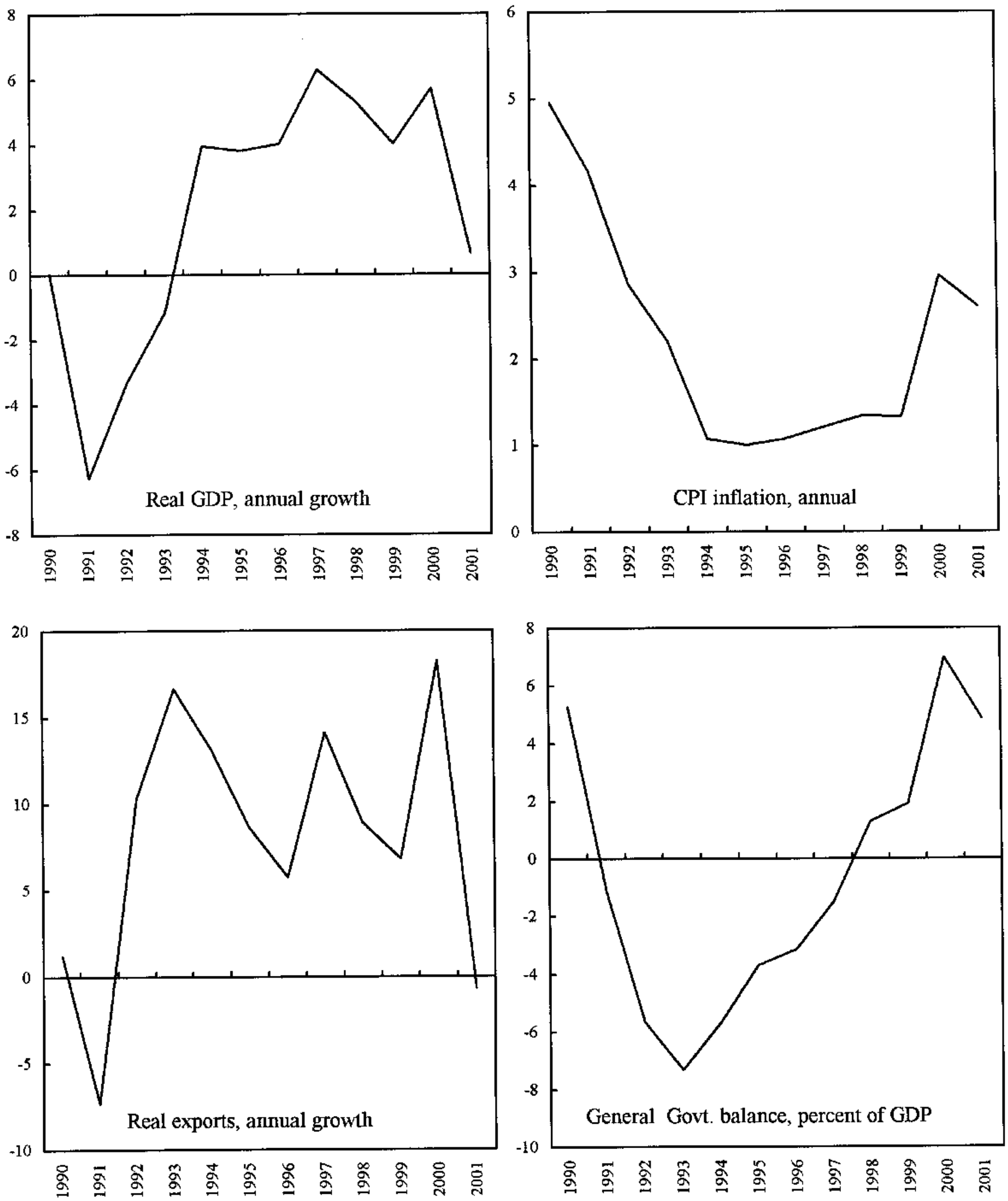
1. ***Finland's recovery from the crisis of the early 1990s is a European success story.*** Based on prudent policy choices and an increasingly open economy, real GDP growth averaged about 5 percent during 1994–2000, inflation was 1–3 percent, and the general government balance moved from large deficits to sizable surpluses (Figure 1 and Table 1). Moreover, increased external competitiveness and market flexibility contributed to Finland's favorable export performance, including both traditional industries and the dynamic ICT sector. The combination of fiscal surpluses and structural reforms—including improvements in labor market performance and increases in the effective retirement age—were important first steps in preparing for the impact of population aging.

2. ***In the face of a deteriorating external environment, economic activity slowed sharply in 2001—and cyclical pressures on inflation receded.*** The abrupt contraction of the ICT market, as well as a decline in traditional exports (e.g., paper, wood, and refined metal products), contributed to a significant decline in both export volume growth and real growth overall. But the ICT sector, which accounted for about half of real GDP growth at the peak of the ICT boom, employs less than 5 percent of all Finnish workers, and the ups and downs of the stock market wealth created by this sector have mainly affected foreign investors.[1] As a result of this dual economy nature, there are only limited spillovers from the dynamic but volatile ICT sector to the rest of the economy, mitigating the repercussions of ICT developments for employment and the domestic economic performance. Real GDP growth in 2001 slowed sharply, but remained positive at about ¾ percent, and employment increased by almost 1½ percent (Figure 2), also supported by broadly accommodative monetary conditions and an expansionary fiscal stance (Table 1 and Figure 3) . In the meantime, year-on-year inflation fell to below 2½ percent by the end of the year, bringing it close to the EU average.

3. ***Certain structural rigidities—likely to hamper Finland's future economic well being if left unattended—have been in evidence.*** The official unemployment rate remained excessive at about 9 percent. Broader measures—which take into account such categories as individuals who left the labor force early, discouraged workers, and others participating in active labor market programs—could be as much as double. Among the factors contributing to high unemployment were inadequate wage differentiation across different skill levels; disincentives to seek work, stay in the labor force, and hire labor, including high taxes on labor; and an underdeveloped market for private services in the non-business, lower-skill sector. While past reforms have made some headway in reducing the tax wedge on labor (i.e., taxes on labor income and social security contributions), the wedge is still high compared with the EU average and even higher when compared to the OECD average (Figure 4). A high tax wedge impedes employment by keeping labor input expensive for firms and rewards low for employees.

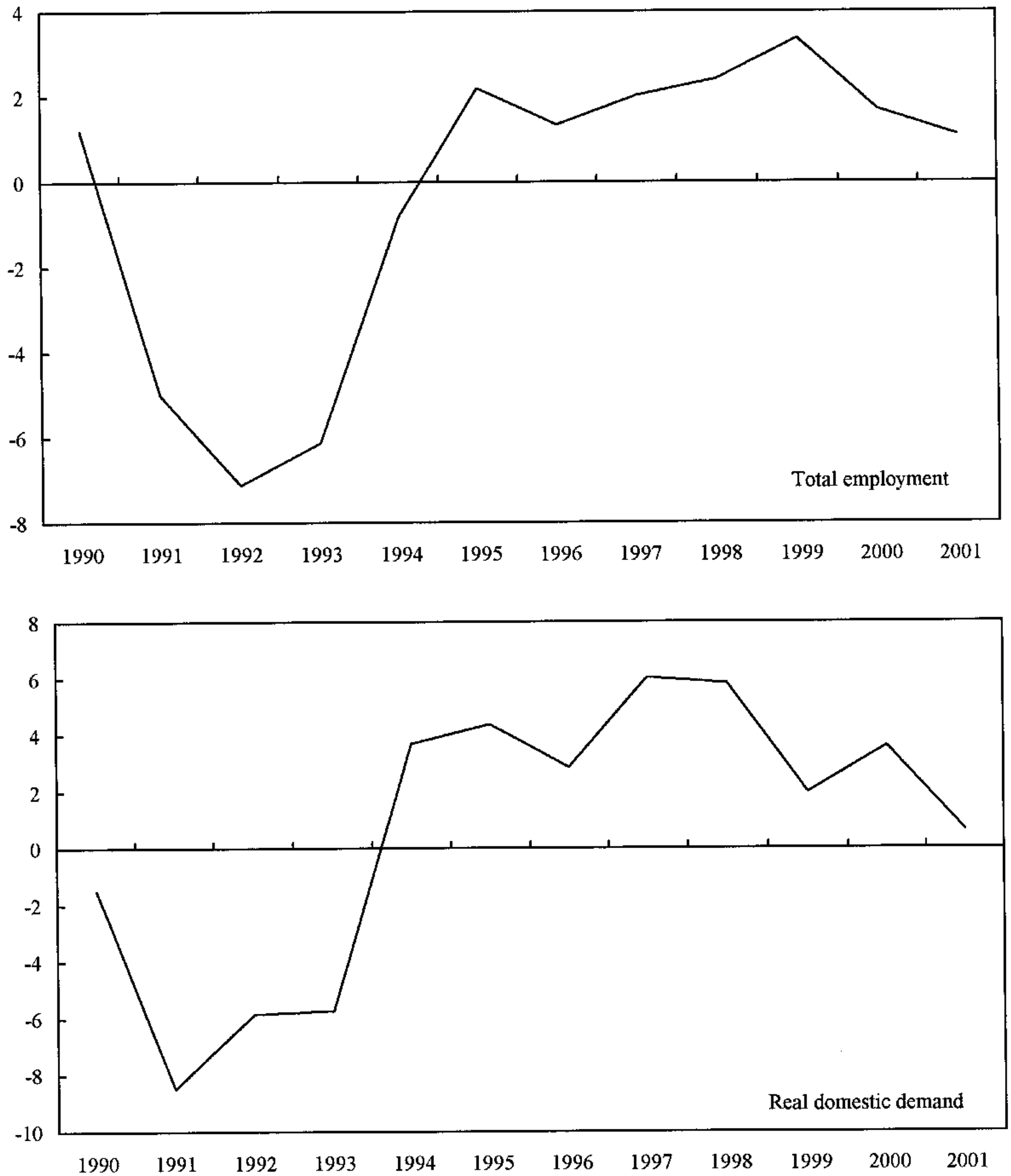
[1] About two-thirds of the ICT sector's total market capitalization is held abroad, and domestic holdings are highly concentrated.

Figure 1. Finland: Selected Economic Indicators, 1990-2001



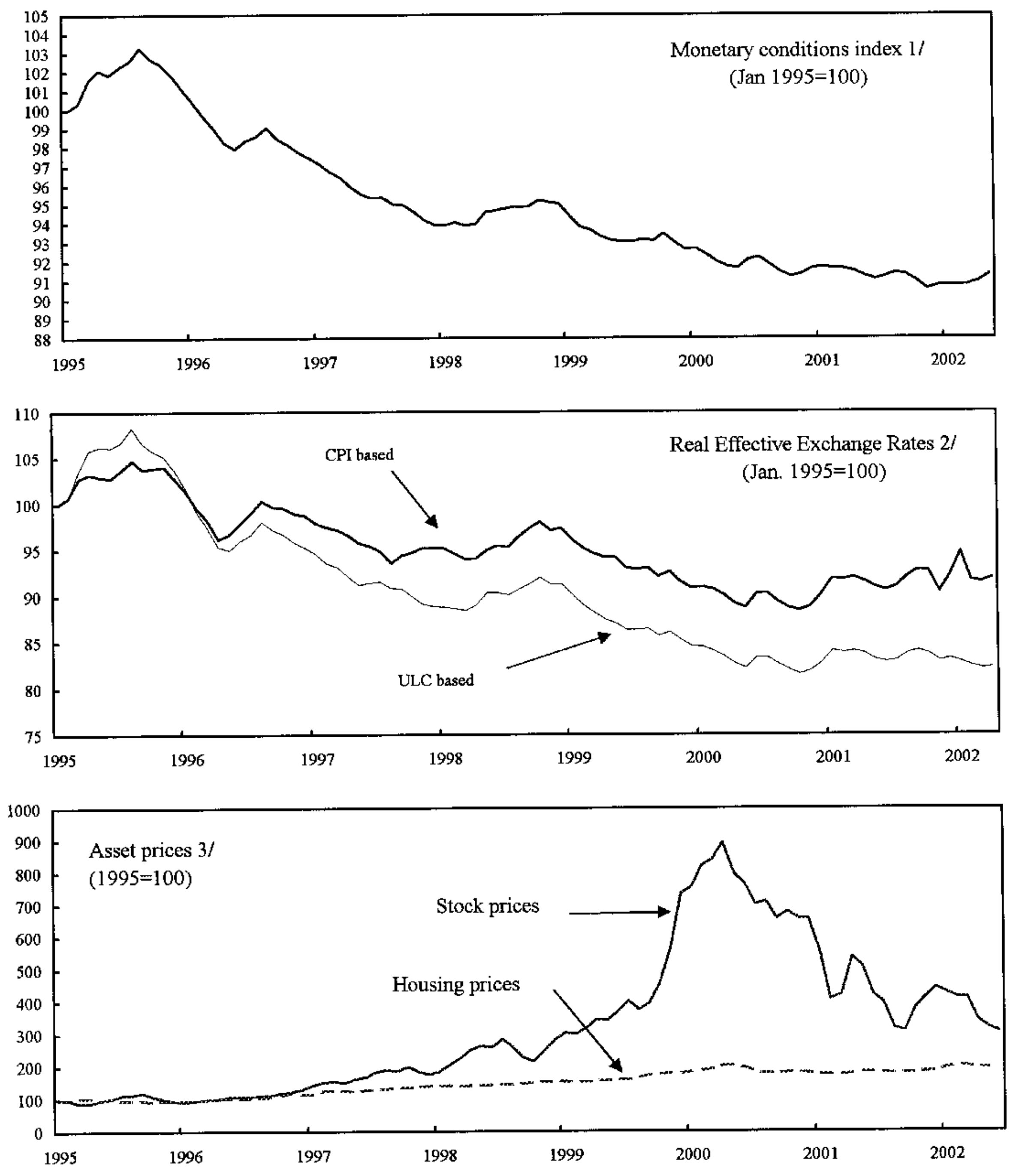
Sources: ETLA, WEO, and staff estimates.

Figure 2. Finland: Employment and Real Domestic Demand, 1990-2001
(Annual Growth)



Sources: ETLA, WEO, and staff estimates.

Figure 3. Finland: Financial Conditions, 1995-2002



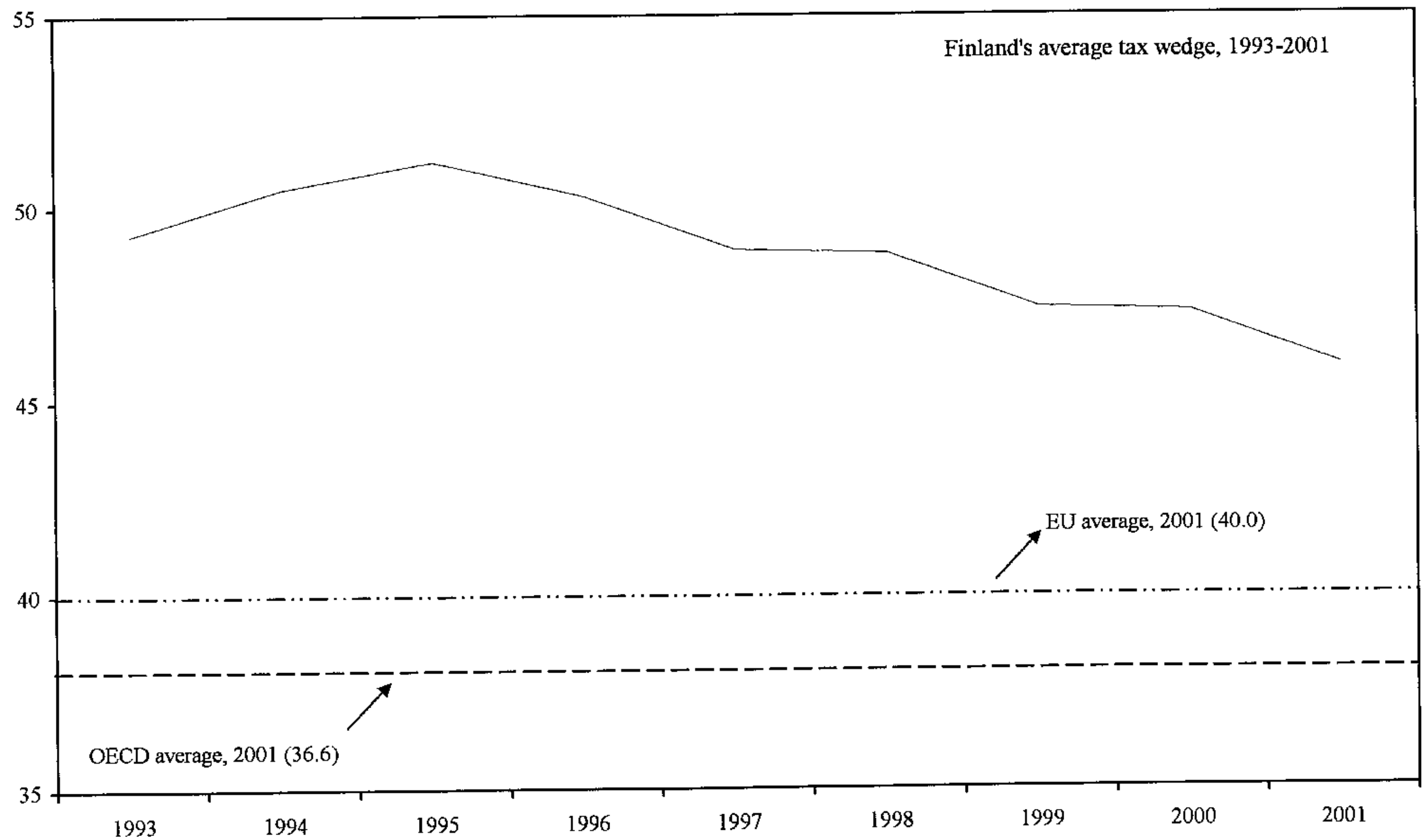
Sources: ETLA, Bank of Finland, Eurostat, and staff estimates.

1/ Based on staff estimates, using weights for real short-term and long-term interest rates and the real effective exchange rate (ULC based) of one-third each.

2/ An increase denotes an appreciation.

3/ All-share HEX index; end-of-month.

Figure 4. Finland: Tax Wedge, 1993-2001 1/



Sources: OECD and staff estimates.

1/ Income tax plus employee and employer contributions (as a percentage of labor costs); single persons without children.

II. Policy Discussions

4. ***The main challenges for economic policy are interrelated: to deal with high unemployment and the impact of a rapidly aging population.*** Finland's population is aging faster than any other EU country, with the old-age dependency ratio [2] expected to increase dramatically to about 40 percent in 2020, and 50 percent in 2030, or almost double today's ratio. Against this background, without actions to significantly raise the employment rate and productivity, economic growth would be reduced drastically as the number of workers declines. This would accentuate the significant pressures on the public finances from the demographic shock, and make it difficult to avoid burdening future generations with excessively high taxes or cutting retirement and health benefits significantly.[3]

5. ***Thus, in addition to the short-term outlook, the discussion focused on key elements for dealing with unemployment and aging.*** This included fiscal policy and the need to prepare for higher age-related spending in the future without jeopardizing the public finances; pension and labor market reforms to raise the rate of employment; and measures to improve the functioning of product and service markets to foster productivity growth and job creation. There was also a follow-up on the findings of the 2001 Financial Sector Stability Assessment (FSSA).

A. Short-Term Outlook and Fiscal Policy

6. ***Growth in 2002 is expected to be lackluster, but to pick up in 2003.*** Real GDP in the first quarter unexpectedly declined from the preceding quarter, with export growth sharply negative and private consumption and investment flat. In light of these developments, the mission marked down its projection of real GDP growth to about 1 percent in 2002, while keeping projected growth in 2003 close to 3 percent. This projection attempts to balance considerable uncertainty about the demand for mobile communication equipment—and the associated impact on Finland's ICT sector—with a number of upside risks. On the downside, there is the risk that third-generation ICT products, though holding considerable potential, may take some time to catch on, and that market saturation of earlier technologies may limit near-term growth in some important markets.[4] The upside includes prospects for robust domestic demand growth underpinned by stronger confidence indicators, in particular for private consumption (Figure 5). The upside also includes a projected pick-up of foreign demand in the course of 2002 alongside Finland's solid external competitiveness position

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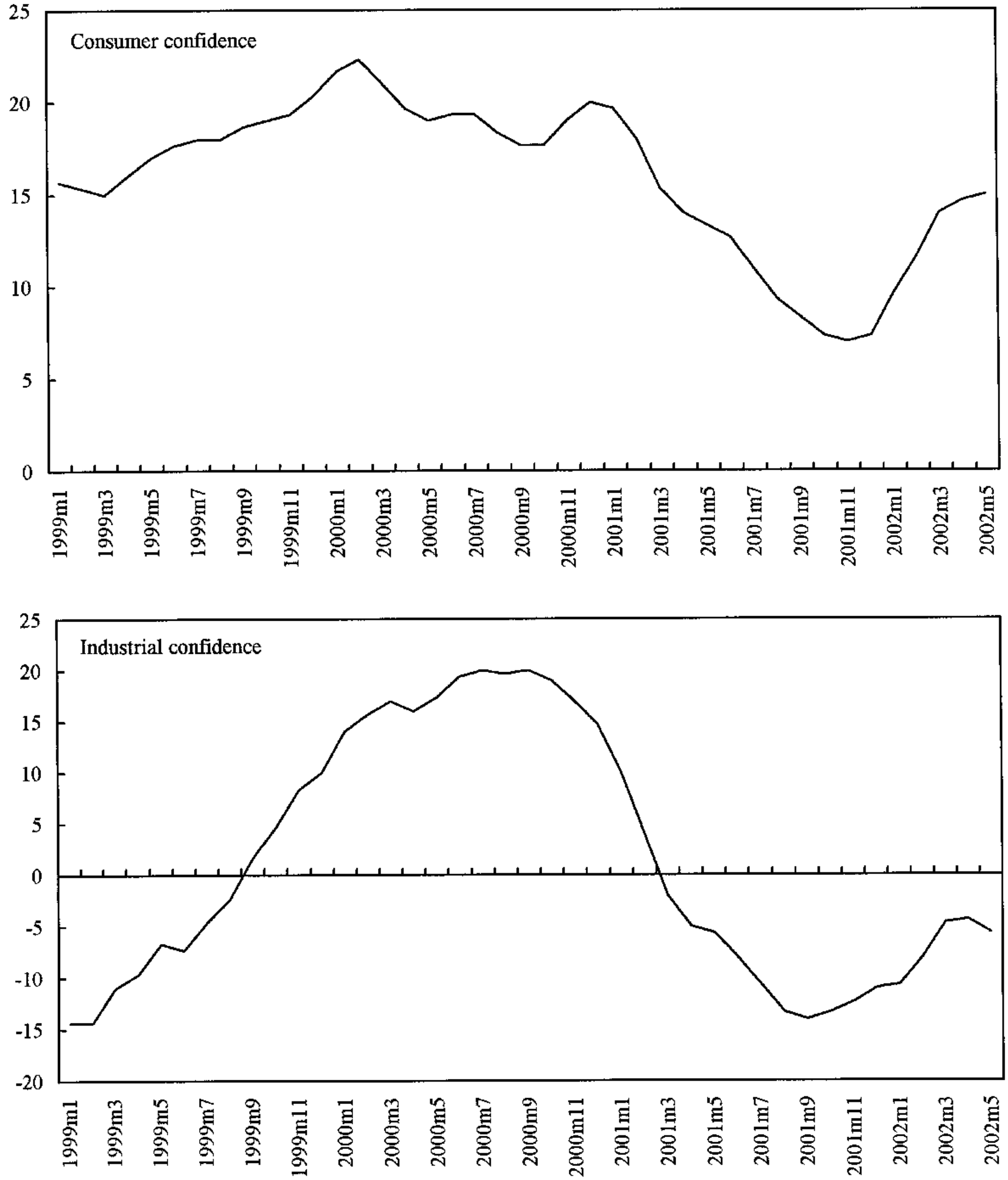
[2] Defined as the population aged 65 and over as a percent of the working age population aged 20–64.

[3] The scope for lowering pension benefits or raising contributions is constrained by social choice—for instance the decision to guarantee pensioners a certain level of real income and health services—as well as by already high overall tax rates.

[4] So-called third-generation (3G) technology aims to provide a seamless integration of mobile phones and the Internet, with broad-ranging high-speed data and voice transmission. For more discussion of the shift to 3G technology, see the selected issues paper for the 2001 Article IV consultation entitled *A Note on Finland's "New Economy"* (IMF Country Report No. 01/215).

Figure 5. Finland: Confidence Indicators, 1999-2002
(Seasonally Adjusted, Centered 3-month Averages)



Sources: European Commission and staff calculations.

(somewhat dampened by the latest appreciation of the euro).[5] Staff's growth forecasts are somewhat lower than the authorities': the Bank of Finland (as of June 2002) and the Ministry of Finance (as of May 2002) expected GDP growth of about 1½ percent in 2002, and about 3 and 3½ percent, respectively, in 2003. The authorities noted upside potential: recent industrial production data was good, which could be indicative of a rebound in exports. However, they also felt that the mission's projections were reasonable, in light of downside risks. With a significant output gap, headline inflation is expected to moderate to 2 percent or less during 2002–03.[6]

7. ***There was broad agreement on the policy strategy to deal with population aging.*** Indeed, staff had supported many of the policy targets specified earlier by the authorities, including expenditure limits to allow room for significant cuts in the tax wedge on labor while safeguarding sufficiently large fiscal surpluses to prepare for the inevitable increase in age-related spending. Without further labor tax cuts, Finland would be less attractive as a destination for foreign capital and internationally mobile high-skilled labor, including Finnish citizens—and it would be more difficult to generate employment for lower-skilled workers. Moreover, all agreed that timing is of essence: the demographic window of opportunity is closing quickly, with the first "baby-boomers" nearing retirement. Thus, it is important to secure adequate fiscal surpluses now, with a view to paying down public debt, reducing future interest payments, and helping to avoid large fiscal deficits after the demographic shock sets in. In addition, various structural reforms are needed to accompany fiscal policy in dealing with the demographic shock: pension reform to raise the effective retirement age (which at 59 years is low); and product and labor market measures aimed at increasing labor demand, raising the employment rate (which now stands at about 68 percent compared to the government's target of 70 percent), and enhancing productivity and economic growth to help reduce the mounting pressures on public finances and the pension system. Importantly, reform measures, by fostering economic growth, are critical to preserving the welfare state—though they are sometimes seen in public debates in the opposite light.

8. ***Unfortunately, fiscal policy is veering off course.*** The targets for the central government specified in the 2000 and 2001 Stability Programs called for central government real expenditure growth of no more than ½ percent per annum over its 2000 level and surpluses of at least 1½ percent of GDP (estimated by the government to be in line with a general

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[5] Measure of the real effective exchange rate (Figure 3)—which were broadly constant in 2001 and the first four months of 2002—indicate that external competitiveness has generally strengthened since the mid-1990s. Finland also benefits from other considerations affecting competitiveness (e.g., those related to the general business environment and capacity for innovation), one indication being Finland's high competitiveness ranking by the World Economic Forum—though high labor taxes remain an issue.

[6] While difficult to measure the size of the output gap, staff estimates it to be significant in 2002 and 2003 (at about –4 percent). This assessment is based on aggregate labor market pressures, which take into account the "dual economy" that allowed Finland to enjoy high ICT-led growth without overheating in the past. While the authorities do not provide official estimates of the output gap, they would agree that output is expected to be well below potential. A discussion of different methods to compute the output gap is contained in *Finland—Selected Issues* (9/15/99).

government surplus of about 4½ percent of GDP). However, on the heels of large fiscal surpluses in 2000 and 2001, political pressures, accentuated by the election cycle (a general election is scheduled for March 2003), have reduced expenditure discipline: the 2002 budget and current plans for 2003 point to broadly-based real spending growth of about 5 percent this year and 1½ percent next year. Combined with cuts in income taxes and social security contributions of ¾ percentage point of GDP in 2002, this, according to staff estimates, implies a surplus of about ½ percent of GDP in 2002 and balance in 2003 for the central government; and, for the general government, a surplus that falls from just under 5 percent of GDP in 2001 to about 3 percent in 2002, and to around 2 percent in 2003.

9. ***A lower-than-targeted fiscal surplus caused by reduced expenditure discipline gives rise to concern.*** Staff noted that a limited decrease in the general government surplus could be acceptable to the extent that it reflected the work of automatic stabilizers and lower taxes on labor (which would support stronger potential output growth). But the anticipated decline in the surplus goes well beyond the effects of tax cuts and allowing the automatic stabilizers to operate:[7] it is largely driven by expenditure growth that exceeds the government's initial targets, undermining prospects for labor tax cuts in the future.

10. ***The discussion thus turned to the advantages of expenditure restraint and the implications for cutting taxes on labor.*** Main points are:

- Similar to the last Article IV consultation and illustrated in Box 1, staff, encouraged by the authorities, explored the potential benefits of labor tax cuts to the tune of 2 percentage points of GDP during 2003–05, compared with a baseline scenario that is broadly in line with the government's existing fiscal plans and keeps taxes on labor constant. In this context, staff urged the authorities to finance these cuts by further spending restraint. Staff felt, however, that the cyclical outlook served to mitigate the risks from tax cuts that were somewhat larger than cuts in spending to the extent that the resulting additional fiscal stimulus would be limited during this period (averaging ½ percentage point of GDP or less, in line with the reform scenario). But, as recognized by the authorities, the importance of establishing more effective overall expenditure discipline needs to be emphasized in this connection.

- Somewhat of a lowering of the general government surplus in the medium term would still allow the public debt to be reduced and leave room for automatic stabilizers to work in the case of a significant economic downturn. Moreover, by comparison to the baseline scenario, the reform scenario that includes the 2 percentage points of GDP cut in labor taxes along with greater restraint on government outlays has a number of advantages—for growth, employment, and the health of the public finances—provided that expenditure discipline is maintained. Figure 6 summarizes the differences between the baseline and the reform scenarios.

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[7] According to staff estimates, the general government's structural primary surplus—corrected for the influence of the business cycle and one-off factors—declined by about ½ percentage point of GDP in 2001 (from around 6 percent of GDP in 2000) and is expected to decline by about another ¾ and ½ percentage point of GDP in 2002 and 2003, respectively (Table 1).

Box 1. A More Ambitious Reform Strategy

What are the benefits of a more ambitious strategy to deal with the demographic shock? This is illustrated by two scenarios summarized in Figure 6.[1]

The **baseline scenario** is based on the government's existing medium-term budget plans for 2002 and 2003 (which includes labor tax cuts in the form of reductions in social security contributions and income taxes of about ¾ percentage point of GDP), the expenditure limits it set for 2004–06, and indirect tax cuts of 1 percentage point of GDP over the 2003–04 period. In the longer-run, expenditure developments are linked to the relevant population segments (for instance, spending on education is assumed to develop in proportion to the 7–19 year old age group and pensions to the age group above 60) and revenues increase broadly in line with GDP. In addition, this scenario incorporates an increase in the effective retirement age by one year—only an approximation of the impact of recent pension reforms.

Figure 6 shows that this strategy would help to bring the general government balance to about 4 percent of GDP toward the end of this decade. Thereafter, the baseline scenario implies a steady decrease in the surplus, as increasing pension and health outlays are only partially offset by higher tax rates and social security contributions (the overall tax ratio increases from about 42½ to 46 percent of GDP between 2020–30). In the long-run, the fiscal budget is in balance, which is broadly in line with the "minimal benchmarks" computed by the European Commission to leave sufficient room for maneuver to accommodate business cycle movements within the Stability and Growth Pact. In this scenario, in the absence of additional measures, the unemployment rate stays near 7½ until 2025, but rises toward the end of the projection period as the tax wedge on labor income increases to keep the general government in balance.

The **reform scenario** is based on more ambitious labor tax cuts backed by further expenditure restraint and additional pension reform measures that reduce incentives for early retirement. In particular, in comparison with the baseline, the reform scenario assumes

- tax revenue decreases by about 3½ percentage points of GDP between 2003 and 2010, with the majority of tax cuts frontloaded in 2003–2005 (specifically, 1 percent of GDP in 2003 and ½ percent of GDP in each of the two subsequent years)
- reductions in real primary expenditure by about 3 percent between 2003 and 2005, followed by only modest expenditure growth until 2030
- an increase in the effective retirement age by an additional 3 years over the entire period.

The budgetary measures imply a somewhat lower fiscal surplus until 2010. However, the risks from additional short-run fiscal stimulus—if measures are taken early on—should be acceptable, given the slack in the economy and prospective monetary conditions, as well as the longer-term benefits.[2] From a longer-term standpoint, additional tax cuts—in combination with the effects of the longer working life due to the additional pension reform measures included in the reform scenario—would ultimately result in higher economic growth, higher employment, and a stronger fiscal position—along with a desired decrease in the size of government. And, in the absence of tax increases in later years, unemployment stabilizes at about 6 percent.

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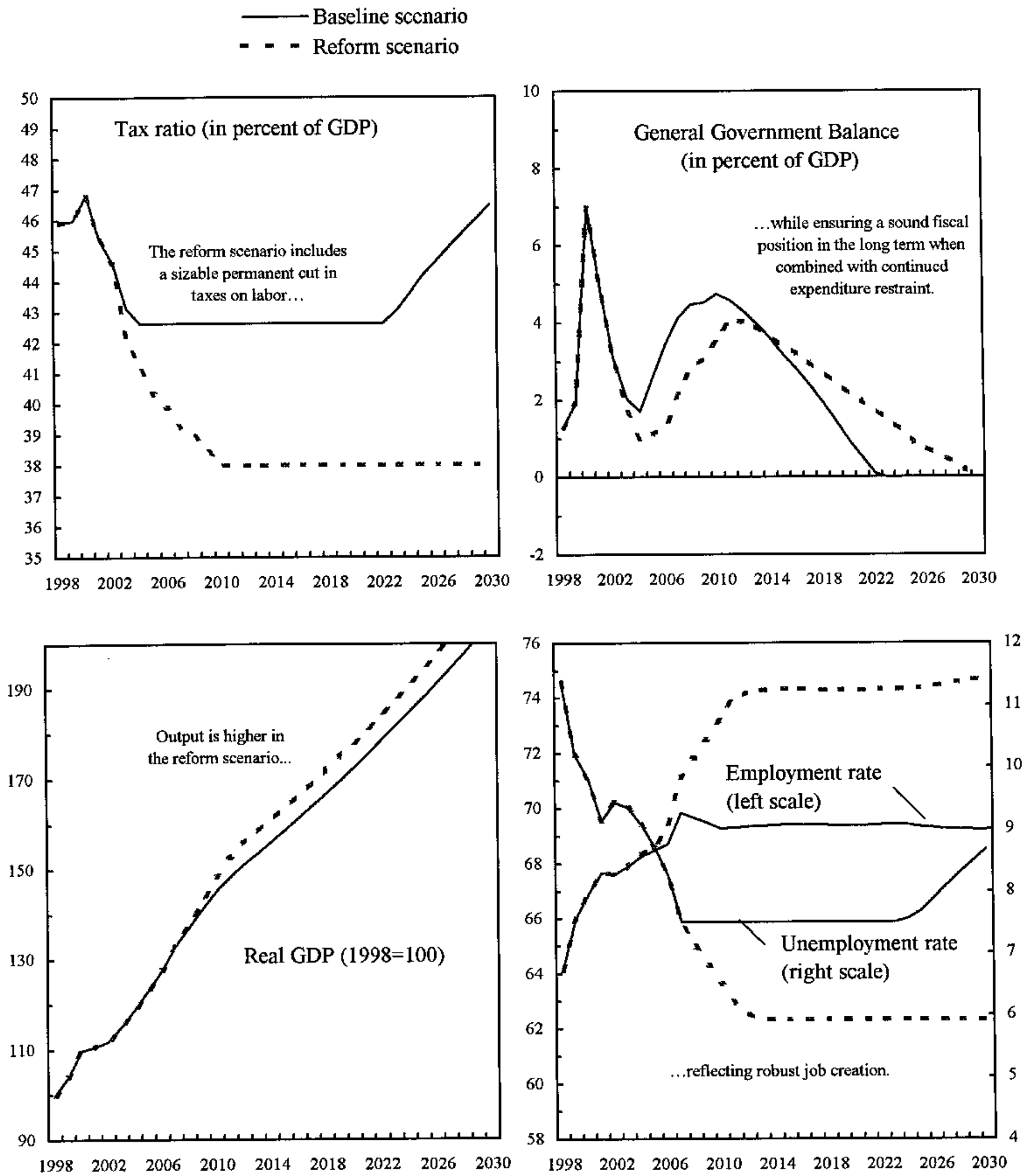
[1] These scenarios update those presented in the Staff Report for the 2001 Article IV Consultation, *IMF Country Report No. 01/213*. The underlying model is described in detail in *Finland—Selected Issues* (SM/99/230), 9/15/99.

[2] Monetary conditions are likely to impose a degree of restraint over the course of the next 12 months. The June consensus forecast foresees short-term and long-term interest rates increasing in Germany—a proxy for the euro area—by 60 and 80 basis points, respectively, and the euro to remain strong against the U.S. dollar.

Figure 6. Finland: Long-Term Scenarios, 1998-2030



Source: IMF staff projections.

- At a minimum, it should be possible to hold central government primary real spending (i.e., excluding interest payments) constant at the level of the 2002 budget for the coming years. Fund staff estimates that it would then be possible to cut labor taxes by about 1 percent of GDP over the 2003–05 period while keeping the central government balance from moving into deficit.

- The authorities recognized, in principle, the advantages of more ambitious tax cuts while holding to spending limits. However, opportunities in this regard will depend on the choices of the new government resulting from the election. It was agreed that measures that both raise revenues and help rationalize public spending—such as user fees—deserve serious consideration, particularly when zero-priced services create overspending in the public domain.[8]

11. ***The recent experience points to some specific areas in which the expenditure framework might be strengthened.*** Broader-based commitment, on the part of parliament as well as the government, is one key consideration for ensuring the success of medium-term expenditure ceilings. The discussions revealed that enhanced commitment might be achieved by including multiyear expenditure ceilings, along with a description of the strategy that lies behind them, when the annual budget is presented to parliament—with a view to generating endorsement of the ceilings, their underlying rationale, and the strategy to achieve them. There could also be the presumption that the subsequent year's ceiling will be a starting point for next year's budget discussions. In addition, switching from real to nominal ceilings has advantages, not least by improving the transparency of the expenditure ceiling framework through publishing targets that will facilitate monitoring by the public of actual expenditure behavior. These ceilings might also exclude interest payments, to strengthen the commitment to expenditure limits on other items, and spending restraint generally. Finally, mechanisms to correct deviations from expenditure targets would clearly be beneficial, for instance by requiring that supplementary expenditure increases outside the regular budget process be accompanied by expenditure cuts elsewhere—a process that could be facilitated by stronger budgeting by objective.

B. Structural Reforms

12. ***Pension reforms already in the pipeline are moving in the right direction, but discussions pointed to areas of concern.*** Reform proposals endorsed by government and social partners in November 2001 include, among other things, the introduction of a more flexible retirement age, greater incentives for a longer working life, and changes to curb usage of early retirement schemes. While these are beneficial and would generate fiscal savings, the majority of the suggested measures will not become effective until 2005, and other suggested reforms seem to run counter to the goal of extending the average work life. In particular, staff noted

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[8] For example, a recent study by the Ministry of Finance noted that the average time taken to complete a degree in higher education is among the highest in the world in Finland and referenced the experience in the Netherlands, where a redesign of higher education financing—by introducing tuition fees and converting student grants into repayable loans if studies are not completed within a set time—clearly increased the pace of graduation.

that a softening of the eligibility criteria for disability pensions—already a well-used path into early retirement—has been proposed to offset the elimination of the individual early retirement plan. Consequently, the overall impact of the reform proposals remains uncertain and, depending on a number of final decisions yet to be made, may be less than hoped for. Against this background, the discussions revealed that a number of other measures to strengthen pension reform and the public finances would be helpful, including by taking into account changes in life expectancy in computing pension benefits and determining the statutory retirement age, and eliminating disincentives to hiring older workers and subsidies to part-time pensioners.

13. ***It was recognized that measures aimed at strengthening both labor supply and labor demand were needed parts of any strategy to raise employment.*** While past efforts to strengthen labor market performance have helped to increase overall labor market flexibility, the combination of high taxes and income-related social benefits continues to give rise to incentive traps, especially at the lower end of the skill-scale. The authorities noted that the earned-income tax allowance (EITA) [9] had brought some success in terms of increasing after-tax income and labor market participation by low-skilled labor, but recognized that impediments to labor demand limited the impact on actual employment. Indeed, while the centralized wage bargaining process has helped to deliver moderate wage increases, on average, the resulting wage compression and consequent loss of competitiveness for low productivity workers tends to aggravate rather than alleviate the employment problem for the less skilled. Thus, even if the EITA succeeds in raising the supply of labor on offer, low demand for less-skilled labor impairs its effectiveness. At the same time, the fading out of the EITA at higher income levels increases effective marginal tax rates for higher-skilled workers, further limiting the overall employment effect of the tax allowance.

14. ***Further product market reforms could help raise the economy's efficiency and create new employment opportunities.*** But the pace of reform has slowed, with privatization efforts—negligible in 2001, when capital injections into state-owned companies widely exceeded revenues from privatization—having revived only recently. At the same time, the authorities recognized that increasing private sector involvement in the provision of publicly-provided services—for example, by making wider use of public procurement and information systems—could improve the efficiency and quality of such services. This would also support the development of the private services sector, where the potential for employment creation is substantial.[10] Competition in some markets could be improved, with market concentration high in many sectors—including construction, energy, telecommunications, and retail. In this regard, recent steps to better inform possible new entrants about the procurement for public construction projects were welcomed by the mission. Nevertheless, the mission encouraged placing priority on more effective implementation of the existing competition law, particularly in the local telecommunications market.

[9] In effect, the EITA provides a tax credit to workers so that the rewards from taking a job are increased. This tax credit increases up to a certain gross wage, but decreases thereafter.

[10] An analysis of Finland's service sector was provided in a selected issues paper for the 2001 Article IV consultation entitled *Labor Market Challenges: Job Creation in the Services Sector* (*IMF Country Report* No. 01/215).

C. The Financial Sector

15. ***The robustness of Finland's financial system has been well demonstrated over the past year.*** Indeed, the positive findings of the 2001 Financial Sector Stability Assessment (FSSA)—that the financial system is sound, with the banking system and the insurance and pension industries well capitalized, profitability of the banking system high, and loan losses very low—have continued to hold, even as some of the worst-case stress test scenarios largely materialized amid the sharp economic slowdown. In addition, indicators of financial vulnerability (Table 2) are broadly favorable. In light of the downside risk clouding the current economic horizon, the mission welcomed the authorities' continued monitoring of the financial system's stability and supported their planned updates of stress testing of the system's resilience to various shocks.

16. ***Against the background of a financial market that is highly concentrated and increasingly dominated by cross-border financial conglomerates, the discussions also focused on some of the supervisory and regulatory changes over the past year.*** These included a draft act on the Financial Supervisory Agency (FSA), a tightening of Nordic supervisory cooperation, and the adoption of a new law on financial conglomerates. While these are steps forward in addressing this complex and demanding financial environment, additional progress—such as further harmonization of the regulatory and supervisory arrangements across both the Nordic and euro areas, and more fully developing a crisis management framework—could enhance the system's stability and reduce the potential for risks. Fund staff indicated that unifying the supervision authority of the FSA with other supervisors, such as for insurance companies, merits further consideration—though, as noted by the authorities, the relevant legislation would also need to be appropriately amended and unified. The authorities and staff viewed the draft act on the FSA as a move toward addressing the independence, accountability, and early intervention powers of the FSA. But staff expressed concerns that the proposed arrangements for the new FSA Board could potentially obfuscate the lines of competence and accountability and undermine the effectiveness of the FSA in some respects, particularly if decisions on licensing and the imposition of sanctions effectively end up being made by the FSA Board (which would be comprised of representatives from the Ministry of Finance, the Bank of Finland, and the Ministry of Health and Social Affairs, with FSA staff possibly having no representation on the Board). Finally, the mission welcomed the authorities' efforts to further strengthen the legislation on anti-money laundering and terrorist financing, and the conformity of legislation to the standards of the OECD's Anti-Bribery Convention, to which Finland is a signatory.

III. Staff Appraisal

17. ***Finland is to be commended for its successes following the severe recession in the early 1990s.*** This includes sound policy choices, including the shift from large fiscal deficits to sizable surpluses, and strong economic performance, reflecting increasing economic openness, improved market flexibility, and enhanced external competitiveness.

18. ***But economic activity slowed sharply in 2001 on the heels of a worsening external environment, and is expected to be somewhat lackluster this year before gathering pace.***

While this implies that output is expected to be well below potential—and hence some limited fiscal stimulus would not be particularly worrisome from a short-term perspective—policy needs to be strongly attuned to Finland's longer term challenges.

19. ***The period ahead is a critical one, in which preparing for population aging should be an overarching goal of policy.*** This requires a concerted effort on a number of fronts to increase the rate of employment; maintain sufficiently large general government surpluses over the medium-term to avoid structural deficits after the demographic shock sets in; find ways to generate new sources of revenue, including through user fees to also help rationalize public expenditure; and adherence to strict public expenditure limits, with a view to leaving room for additional tax cuts on labor without jeopardizing the public finances.

20. ***In the context of needed labor tax cuts, it is essential to reverse the recent softening of expenditure discipline and strengthen the institutional backing to adhere to medium-term expenditure ceilings.*** At a minimum, staff would urge the authorities to hold primary real spending constant at the budgeted level in 2002, with a view to cutting labor taxes by 1 percent of GDP over the 2003–05 period. More preferable, in the context of improved expenditure discipline, would be a front-loaded reduction in the labor tax burden (on the order of 1 percent of GDP in 2003 and ½ percent of GDP in 2004 and 2005), mostly financed by further expenditure restraint but also allowing some limited short-term fiscal stimulus. When judged against the potential benefits to employment and growth, the risks from limited additional fiscal stimulus would seem worth taking in circumstances in which inflation is set to fall, output is expected to be below potential, and the general government surplus is expected to rise.

21. ***Pension reform has an important role to play, as an integral part of the strategy to raise the low average retirement age and the effective supply of labor, and keep social security spending in check.*** Recently proposed reforms to make a longer working life more attractive should be implemented as quickly as possible, while the proposal to soften the eligibility criteria for disability pensions needs to be reconsidered. To further support the goals of raising potential GDP growth and strengthening the public finances, additional measures must be contemplated, for example: eliminating the subsidized component of the part-time pension scheme as well as disincentives for hiring older workers; basing the pensionable wage on lifetime earnings; and calibrating the statutory retirement age to take into account changes in life expectancy.

22. ***Other measures in the labor and product markets, aimed at fostering employment creation and the functioning of the economy, would be beneficial.*** One key aspect is for the social partners to find ways to introduce greater wage differentiation commensurate with diverse productivity developments and labor demand, which could be achieved by allowing greater room for setting wages at the firm level. In a related vein, this would also enhance the effectiveness of tax-based labor supply incentives, such as the earned-income tax allowance, by ensuring sufficient demand. Other reforms aimed at rewarding work would improve the flexibility and supply response of the economy. In addition to tax cuts on labor, these include modifications to the unemployment and benefits systems to avoid penalizing taking a job by making work financially more attractive relative to unemployment (and early retirement for

that matter). Finally, reinvigorating privatization efforts—the proceeds should be used to pay down public debt—increasing private sector involvement in the provision of public services, and strengthening the degree of competition in product markets should be seen as key policy objectives.

23. ***To take advantage of the demographic window of opportunity that is closing rapidly, reform measures should be taken without delay.*** Otherwise rapid population aging will complicate the prospects for an alleviation of the heavy burden of taxes on labor, and for a significant and lasting improvement in employment growth. But with a determined effort, public expenditure limits, coupled with wide-ranging structural reforms and tax cuts, could trigger a virtuous circle of strong employment creation, solid economic growth, and fiscal savings—without which Finland would find it difficult to meet its social welfare objectives.

24. ***Notwithstanding the financial system's current soundness, further strengthening of regulatory and supervisory arrangements would help mitigate future risks.*** In particular, efforts toward harmonizing the cross-border and the cross-discipline regulatory and supervisory arrangements should be a priority. At the same time, to underpin the effective functioning of the Financial Supervisory Authority (FSA) and avoid obfuscating lines of competence and accountability, it is important to ensure that decisions on licensing and the imposition of sanctions are made at the operational level of the FSA and not at the policy-making level of the new FSA Board. Finally, the further strengthening of legislation on anti-money laundering and terrorist financing is most welcome, as is Finland's adherence to the OECD's Anti-Bribery Convention.

25. ***It is recommended that the next Article IV consultation with Finland remain on the 12-month cycle.***

Table 1. Finland: Main Economic Indicators, 1999-2003 1/

	1999	2000	2001	2002 Proj.	2003 Proj.
	(Percentage change, unless otherwise indicated)				
Output and demand (volumes)					
GDP	4.1	5.6	0.7	1.1	3.0
Domestic demand	2.0	3.6	0.7	0.8	2.1
Consumption	3.4	1.5	1.5	1.9	2.2
Private consumption	4.0	2.2	1.4	1.5	2.2
Public consumption	1.9	-0.2	1.7	3.0	2.1
Gross fixed capital formation	3.0	4.8	2.1	-1.8	1.9
Private investment	4.0	6.8	1.8	-2.7	1.9
Public investment	-2.4	-6.3	3.9	4.2	2.2
Export of goods and services	6.8	18.2	-0.7	0.0	4.3
Import of goods and services	4.0	16.2	-1.0	-1.1	3.3
Foreign contribution to growth (in percent of GDP)	1.6	2.6	0.0	0.4	0.9
Prices, costs, and income					
Consumer price inflation (harmonized)	1.3	3.0	2.7	2.2	1.9
Core inflation (excluding energy and seasonal food)	1.1	2.0	3.1	2.5	2.1
GDP deflator	-0.2	3.2	2.2	1.9	1.4
Terms of trade	-5.0	-4.6	2.3	0.2	-1.2
Unit labor cost, manufacturing	-3.3	-5.8	3.6	1.2	0.1
Labor market					
Labor force	2.0	1.2	0.6	0.0	0.5
Employment	3.4	1.7	1.4	-0.2	0.6
Unemployment rate (in percent)	10.2	9.8	9.1	9.4	9.3
Potential output and NAIRU					
Output gap (in percent of potential output) 3/	-0.9	-0.2	-2.7	-4.2	-4.2
Growth in potential output	3.9	4.8	3.3	2.6	3.0
NAIRU (in percent)	10.2	9.7	9.2	8.9	8.5
	(In percent)				
Money and interest rates					
M3 (Finnish contribution to euro area , growth rate, e.o.p.)	6.6	-3.4	4.3	...	...
Domestic credit (growth rate, e.o.p.)	14.2	6.4	6.9	...	...
3-month money market rate	3.0	4.4	4.3	3.3	3.9
10-year government bonds yield	4.7	5.5	5.0	5.3	5.6
Monetary condition index 4/	93.3	91.9	91.3	90.9	
	(In percent of GDP, unless otherwise indicated)				
National savings, investment, and income					
Gross national saving	25.2	27.9	26.4	27.0	27.3
Gross domestic investment	19.2	20.6	20.0	19.7	19.8
Private saving	20.5	18.4	18.7	21.2	22.7
Household saving as percent of disposable income	3.8	1.6	3.3	3.7	4.0
Private investment	16.4	18.1	17.1	16.9	17.2
Government savings surplus	1.9	7.0	4.9	3.1	2.0
Household's real disposable income (increase in percent)	4.5	-0.4	2.9	1.6	2.2

Table 1. Finland: Main Economic Indicators, 1999-2003 (concluded) 1/

	1999	2000	2001	2002 Proj.	2003 Proj.
	(In percent of GDP, unless otherwise indicated)				
Public finances					
General government 5/					
Revenues 6/	49.1	50.8	49.5	49.1	47.4
Expenditure	47.2	43.8	44.7	46.1	45.3
General Government balance	1.9	7.0	4.9	3.1	2.0
of which: net interest on public debt	1.6	1.0	0.8	0.5	0.4
Primary balance 7/	3.5	8.0	5.6	3.6	2.5
Structural balance (in percent of potential GDP) 8/	2.3	7.1	6.0	5.1	4.1
Structural primary balance (in percent of potential GDP) 7/ 8/	3.9	8.1	6.8	5.6	4.5
...corrected for one-off factors 9/	3.9	6.1	5.7	5.0	4.5
One-off factors 9/	...	2.0	1.1	0.6	...
Debt (EMU definition) 10/	47.3	44.3	43.6	44.1	43.7
Central government 5/					
Revenues	25.1	27.2	25.5	25.3	24.4
Expenditure	25.8	23.8	23.7	24.7	24.4
of which: net interest on public debt	3.9	3.4	3.0	2.8	2.7
Central Government balance	-0.7	3.4	1.9	0.6	0.0
Debt 10/	56.5	48.3	45.7	44.8	43.2
Balance of payments					
Current account balance 11/	6.0	7.4	6.5	7.3	7.6
Trade balance	9.5	11.4	10.5	9.8	9.9
Net external debt (excluding equity FDI and shares)	17.7	13.8	5.8	-1.7	-9.2
Exchange rates (period average)					
Euro per US$ (post-1999; FIM per US$ before)	0.94	1.09	1.12	...	...
Nominal effective rate (INS, increase in percent)	-2.7	-5.2	1.8	...	...
Real effective rate (increase in percent) 12/	-3.8	-4.8	0.6	...	...

Sources: Ministry of Finance, Bank of Finland; and staff projections.

1/ Projections are staff estimates based on the authorities' current policy indications.
2/ Wages and salaries, plus employers' social security contributions, divided by working hours of employees.
3/ A negative value indicates a level of potential output that is larger than actual GDP.
4/ Using weights for real short- and long-term interest rates and the real effective exchange rate (ULC) of 1/3 each.
5/ On ESA95 basis.
6/ The fall in revenues in 2003 reflects, in part, planned cuts in some indirect taxes as well as the fading out of one-off factors related to exceptional tax revenues due to income from stock options in earlier years.
7/ Defined as noninterest (structural) revenue minus noninterest (structural) expenditure.
8/ Corrected for the influence of the business cycle as measured by the output gap.
9/ One-off factors include exceptional tax revenues due to income from stock options.
10/ Includes stock-flow adjustements reflecting changes in the portfolio allocation of Finnish pension funds.
11/ For 2004-06, staff expects a current account balance that stays above 7 percent of GDP.
12/ Based on relative normalized unit labor costs.

Table 2. Finland: Indicators of Financial Vulnerability, 1996-2001

	1996	1997	1998	1999	2000	2001
Households						
Total household debt (in percent of GDP)	32.8	30.7	30.5	31.5	30.2	31.8
Debt-to-income ratio	61.1	57.5	58.5	61.2	63.7	65.3
Non-financial corporations						
Gross debt (in percent of GDP)	53.7	48.7	46.2	48.2	52.8	53.0
Debt to equity ratio	52.5	44.2	38.9	30.3	...	...
Debt-to-equity ratio 1/	73.1	60.9	57.9	60.2	...	...
Government						
General government debt (EMU definition, in percent of GDP)	57.1	54.1	48.8	47.2	44.1	44.2
Central government debt (in percent of GDP)	67.5	65.3	60.2	56.5	48.2	46.1
Banking sector						
Outstanding credit to nonfinancial private sector (percent change, e.o.p.) 2/	2.7	4.0	12.1	15.2	5.5	6.9
Of which housing loans (percent change, e.o.p.)	1.3	3.5	13.1	15.8	10.6	11.5
Housing loans in percent of total lending to nonfinancial private sector	36.4	36.2	36.5	36.7	38.5	40.1
Asset Quality						
Non-performing loans/total loans (in percent) 3/	2.8	1.8	1.2	1.0	0.6	0.6
Capital Adequacy						
BIS capital asset ratio	11.4	11.9	11.5	11.9	11.6	10.5
Equity / total assets (percent)	5.5	5.6	5.7	5.8	6.0	5.7
Profitability						
Interest rate margin 4/	4.1	4.3	4.0	3.5	4.3	3.5
Net interest income as a percentage of total income	52.8	59.6	57.1	58.5	46.8	54.5
Return on equity (percent)	11.8	16.7	25.8	20.1	22.4	23.8
Return on assets (percent)	0.6	0.7	1.2	1.0	1.2	1.2
Liquid assets/total assets (percent) 5/	20.5	21.6	19.3	19.6	15.2	17.5
Off-balance sheet liabilities/total assets (percent)	15.3	15.4	16.0	15.9	18.7	20.4
Stock Market						
Change in stock market index (in percent, e.o.p.)	46.5	32.3	68.5	162.0	-10.6	-32.4
Change in housing price index (in percent, e.o.p.)	19.0	21.9	9.5	16.2	0.1	4.3

Sources: Bank of Finland, The Finnish Bankers' Association, Financial Supervision Authority, Statistics Finland, and staff estimates.

1/ Defined as total debt as a percentage of common equity. Data source is Worldscope database. Estimates are based on accounting or book value of equity.

2/ Euro-denominated lending only, which accounted for about 98 percent of total lending in 1999 and 2000.

3/ Loans are defined as the sum of claims on: credit institutions, the public, and public sector entities.

4/ Average lending rate minus average deposit rate.

5/ Liquid assets are defined as the sum of bills discounted by the central bank, debt securities, and the balance sheet item "liquid assets".

Finland: Fund Relations
(As of June 30, 2002)

I. **Membership Status**: Joined 1/14/48; Article VIII.

II. **General Resources Account**:

	SDR Million	Percent Quota
Quota	1,263.80	100.0
Fund holdings of currency	831.78	64.4
Reserve position in Fund	450.00	35.6

III. **SDR Department**:

	SDR Million	Percent Allocation
Net cumulative allocation	142.69	100.0
Holdings	143.25	100.4

IV. **Outstanding Purchases and Loans**: None

V. **Financial Arrangements**: None

VI. **Projected Obligations to Fund**: None

VII. **Exchange Rate Arrangements**

1. Finland is a founding member of EMU, with a euro conversion rate of Finnish markka (Fmk) 5.94573. Finland has accepted the obligations of Article VIII and maintains an exchange system that is free of restrictions on payments and transfers of current international transactions. In accordance with Executive Board Decision No. 144–(52/51), Finland notified the Fund on September 5, 1990 and July 6, 1992 of exchange restrictions pursuant to UN Security Council Resolutions against Iraq and the Federal Republic of Yugoslavia (Serbia/Montenegro), respectively. On July 27, 1995, Finland also notified the Fund of exchange restrictions imposed against Libya, and of changes in the exchange restrictions pursuant to UN Security Council Resolutions on Iraq and the Federal Republic of Yugoslavia (Serbia/Montenegro) as well as on certain areas in the Republic of Bosnia and Herzegovina. Finland has since removed restrictions imposed against certain areas of the Republic of Croatia, the Republic of Bosnia and Herzegovina, and the Federal Republic of Yugoslavia (except for the prohibition on the satisfying of certain claims). The UN Security Council Resolution on food for oil (Iraq) was implemented in December 1996.

VIII. **Last Article IV Consultation**

2. Discussions for the 2001 Article IV consultation were held in Helsinki during June 7–18, 2001. The Staff Report (SM/01/288, 9/21/01) was discussed by the Executive Board on November 9, 2001 (SUR/01/119, 11/13/02).

Finland: Core Statistical Indicators

(As of July 15, 2002)

	Exchange Rates	Internat-ional Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money 1/	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Central Government Balance	GDP
Date of Latest Observation	2-Jul	May	May	May	May	May	June	April	April	May	2002 Q1
Date Received	2-Jul	June	June	June	June	June	July	June	June	June	June
Frequency of Data	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly
Frequency of Reporting	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly
Source of Update	Bank of Finland	Bank of Finland	Bank of Finland	Bank of Finland	Bank of Finland	Bank of Finland	ETLA 2/	Bank of Finland	Bank of Finland	Bank of Finland	ETLA
Mode of Reporting	On-line	On-line	On-line	On-line	On-line	On-line	On-line	On-line	On-line	On-line	On-line
Confidentiality	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public
Frequency of Publication	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly

1/ Finnish contribution to euro area M3.

2/ ETLA is the Research Institute of the Finnish Economy.

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 02/91
FOR IMMEDIATE RELEASE
August 15, 2002

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2002 Article IV Consultation with Finland

On August 13, 2002, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Finland.[1]

Background

Finland's recovery from the crisis of the early 1990s is a European success story. Based on prudent policy choices and an increasingly open economy, real GDP growth averaged about 5 percent during 1994–2000, inflation was 1–3 percent, and the general government balance moved from large deficits to sizable surpluses. Moreover, increased external competitiveness and market flexibility contributed to Finland's favorable export performance, including both traditional industries and the dynamic information and communications technologies (ICT) sector. The combination of fiscal surpluses and structural reforms—including improvements in labor market performance and increases in the effective retirement age—were important first steps in preparing for the impact of population aging.

In the face of a deteriorating external environment, economic growth slowed sharply in 2001, but is expected to pick up significantly by 2003 after staying somewhat lackluster this year. The abrupt contraction of the ICT market, as well as a decline in traditional exports, contributed to a significant decline in both export volume growth and real growth overall in 2001. However, due to the dual economy nature of the Finnish economy—characterized by only limited spillovers from the dynamic but volatile ICT sector to the rest of the economy—the repercussions of ICT

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. In this PIN, the main features of the Board's discussions are described.

developments for employment and the domestic economy were limited. On balance, real GDP growth stayed positive at about ¾ percent, and employment increased by almost 1½ percent. While considerable uncertainties remain, in particular with regard to the ICT sector and prospects for investment, Fund staff expects real GDP growth to increase gradually to about 1 percent in 2002 and about 3 percent in 2003—somewhat less than the authorities' projections. With a significant output gap, headline inflation is expected to moderate to 2 percent or less during 2002–2003.

Certain structural rigidities—likely to hamper Finland's future economic well being if left unattended—have been in evidence. The official unemployment rate remained excessive at about 9 percent. Broader measures—which take into account such categories as individuals who left the labor force early, discouraged workers, and others participating in active labor market programs—could be as much as double. Among the factors contributing to high unemployment were inadequate wage differentiation across different skill levels; disincentives to seek work, stay in the labor force, and hire labor, including high taxes on labor; and an underdeveloped market for private services in the non-business, lower-skill sector. While past reforms have made some headway in reducing the tax wedge on labor (i.e. taxes on labor income and social security contributions), the wedge is still high compared with the EU average and even higher when compared to the OECD average.

The main challenges for economic policy are interrelated: to deal with high unemployment and the impact of a rapidly aging population. Finland's population is aging faster than any other EU country. Against this background, without actions to significantly raise the employment rate and productivity, economic growth would be reduced drastically as the number of workers declines. This would accentuate the significant pressures on the public finances from the demographic shock. All this has important implications for fiscal policy and structural policies to broaden labor market participation, including reforms in the areas of pensions, the labor market, and the product market.

Executive Board Assessment

Executive Directors endorsed the thrust of the staff appraisal. They commended the Finnish authorities for their successes following the severe recession in the early 1990s. This included sound policy choices, including the shift from large fiscal deficits to sizable surpluses, and strong economic performance, reflecting increasing economic openness, improved market flexibility, and enhanced external competitiveness. Directors emphasized that, while the pace of economic activity slowed in 2001 and output is expected to be below potential in the period ahead, policy needs to be strongly attuned to Finland's long-term challenges.

In view of rapid population aging, Directors stressed that the period ahead is a critical one, in which preparing for the demographic shock should be an overarching goal of policy. This requires a concerted effort on a number of fronts to increase the rate of employment; maintain sufficiently large general government surpluses over the medium-term to avoid structural deficits after the demographic shock sets in; find ways to generate new sources of revenue, including through user fees to also help rationalize public expenditure; and adherence to strict public expenditure limits, with a view to leaving room for additional tax cuts on labor without jeopardizing the public finances. In this context, Directors viewed it as essential to reverse the recent expenditure overruns and urged the authorities to strengthen the institutional backing to adhering to medium-term expenditure ceilings. At a minimum, they urged the authorities to hold primary real spending constant at the budgeted 2002 level, with a view to cutting labor taxes by 1 percentage point of GDP over the 2003-05 period. But, considering the near-term cyclical outlook and the longer-term potential benefits to employment and growth, they advocated even larger, frontloaded labor tax cuts—financed to the extent possible by further expenditure restraint, embedded in a long-term strategy to ensure fiscal discipline.

Directors underlined that pension reform had an important role to play, as an integral part of the strategy to raise the low average retirement age and the effective supply of labor, and keep social security spending in check. They recommended that recently proposed reforms to make a longer working life more attractive should be implemented as quickly as possible, while urging the authorities to reconsider the proposal to soften the eligibility criteria for disability pensions. To further support the goals of raising potential GDP growth and strengthening the public finances, Directors also stressed that additional measures must be contemplated, for example: eliminating the subsidized component of the part-time pension scheme as well as disincentives for hiring older workers; basing the pensionable wage on lifetime earnings; and calibrating the statutory retirement age to take into account changes in life expectancy.

To further foster employment creation and the functioning of the economy, Directors saw other measures in the labor and product markets as beneficial. They stressed that one key aspect is for the social partners to find ways to introduce greater wage differentiation commensurate with diverse productivity developments and labor demand, which could be achieved by allowing greater room for setting wages at the firm level. In a related vein, this would also enhance the effectiveness of tax-based labor supply incentives, such as the earned-income tax allowance, by ensuring sufficient demand. Directors noted that other reforms aimed at rewarding work would improve the flexibility and supply response of the economy. In addition to tax cuts on labor, these include modifications to the unemployment and benefits systems to avoid penalizing taking a job by making work financially more attractive relative to unemployment (and early retirement for that matter). Finally, Directors saw reinvigorating privatization efforts—and using the proceeds to pay down public debt—increasing private sector involvement in the provision of public services, and strengthening the degree of competition in product markets as key policy objectives.

Directors emphasized that the demographic window of opportunity is closing rapidly. Thus reform measures should be taken without delay. Otherwise rapid population aging will complicate the prospects for an alleviation of the heavy burden of taxes on labor, and for a significant and lasting improvement in employment growth. But, in the view of Directors, with a determined effort, public expenditure limits, coupled with wide-ranging structural reforms and tax cuts, could trigger a virtuous circle of strong employment creation, solid economic growth, and fiscal savings—without which Finland would find it difficult to meet its social welfare objectives.

Notwithstanding the financial system's current soundness, Directors highlighted that further strengthening of regulatory and supervisory arrangements would help mitigate future risks. In particular, efforts toward harmonizing the cross-border and the cross-discipline regulatory and supervisory arrangements should be a priority. At the same time, to underpin the effective functioning of the Financial Supervisory Authority (FSA) and avoid obfuscating lines of competence and accountability, Directors emphasized the importance of ensuring that decisions on licensing and imposition of sanctions are made at the operational level of the FSA and not at the policy-making level of the new FSA Board.

Directors commended the authorities for further strengthening of legislation on anti-money laundering and terrorist financing, and for the conformity of Finland's legislation to the standards of the OECD Anti-Bribery Convention, to which Finland is a signatory. They also praised the generally high quality, comprehensiveness, and timeliness of Finland's economic statistics.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2002 Article IV Consultation with Finland is also available.

Finland: Selected Economic Indicators

	1999	2000	2001	2002 1/
Real economy				
GDP (change in percent)	4.1	5.6	0.7	1.1
Domestic Demand (change in percent)	2.0	3.6	0.7	0.8
Harmonized CPI (change in percent) 2/	1.3	3.0	2.7	2.2
Unemployment rate (in percent) 2/	10.2	9.8	9.1	9.4
Gross national saving (in percent of GDP)	25.2	27.9	26.4	27.0
Gross domestic investment (in percent of GDP)	19.2	20.6	20.0	19.7
Public finances (general government, in percent of GDP)				
Overall balance	1.9	7.0	4.9	3.1
Primary balance 3/	3.5	8.0	5.6	3.6
Gross debt (EMU-definition) 4/	47.3	44.3	43.6	44.1
Money and credit (end of year, percentage change)				
M3 (Finnish contribution to euro area) 5/	6.6	-3.4	4.3	8.7
Total domestic credit 5/	14.2	6.4	6.9	13.4
Interest rates (year average)				
Three-month money market 6/	3.0	4.4	4.3	3.4
Ten-year government bonds 6/	4.7	5.5	5.0	5.2
Balance of payments (in percent of GDP)				
Trade balance	9.5	11.4	10.5	9.8
Current account	6.0	7.4	6.5	7.3
Fund position (as of end-May, 2002)				
Fund holding of currency (in percent of quota)		65.8		
Holdings of SDRs (in percent of allocation)		100.4		
Quota (in millions of SDRs)		1,263.80		
Exchange rate				
Exchange rate regime		Euro		
Present rate (July 10, 2002)		US$ 0.9878 per euro		
Nominal effective exchange rate (increase in percent) 7/	-2.7	-5.2	1.8	-0.2
Real effective exchange rate (increase in percent) 8/	-3.8	-4.8	0.6	-1.5

Sources: Finnish authorities, International Financial Statistics, and IMF staff estimates.

1/ IMF staff projections, unless otherwise indicated.
2/ Consistent with Eurostat methodology.
3/ Defined as noninterest revenue minus noninterest expenditure.
4/ Projection for 2002 is based on the assumption of unchanged government assets.
5/ For 2002, annualized increase to April.
6/ For 2002, average to June.
7/ For 2002, average 12-month increase to April.
8/ Based on unit labor costs. For 2002, average 12-month increase to May.