HIGHLIGHTS

# The Impact of Regulation on International Investment in Finland


OECD

Co-funded by the European Union via the Structural Reform Support Programme

# Policy highlights – The Impact of Regulation on International Investment in Finland

Foreign investment brings many benefits for the Finnish economy. As competition for international investment intensifies, ensuring that Finland remains an attractive investment destination is essential. However, despite its openness to trade and investment, Finland is lagging behind its Nordic-Baltic peers in terms of total level of foreign investment in its economy. What aspects of Finland's domestic regulation and business environment matter for foreign investors, and to what extent does its regulatory landscape facilitate or discourage foreign investment?


The OECD report **The Impact of Regulation on International Investment in Finland** benchmarks the Finnish regulatory environment for investment against a comparator group of Nordic-Baltic countries, identifies possible bottlenecks and offers policy reflections that the Finnish Government could consider in its efforts to streamline domestic regulation, improve Finland's business climate and strengthen the country's attractiveness for new foreign investors. This booklet summarises the main findings in the report.

# International investment contributes to the Finnish economy in many ways

Foreign direct investment (FDI) contributes significantly to Finland's economic activity and job creation. While representing slightly over 1% of all companies in Finland in 2019, foreign-owned firms were responsible for nearly one-quarter of the overall turnover generated in the Finnish economy and employed over 18% of domestic workforce. In terms of R&D activity, foreign multinational enterprises (MNEs) accounted for 29% of R&D expenditure and employed 26% of R&D workforce in Finland.

But foreign affiliates also bring broader, indirect benefits for Finland:

- Through partnerships with domestic firms and intra-firm labour mobility, foreign MNEs encourage the spread of innovative technologies, particularly in knowledge-based services sectors.
- Foreign-owned firms improve the quality of Finnish jobs. Highly-skilled employees earn, on average, 30% higher annual wages in foreign-owned MNEs than in domestic businesses with no international ties. MNEs also employ more skilled workforce: In 2016, nearly one in two workers in domestic- and foreign-owned multinationals in Finland was high-skilled, compared to less than one in three in domestic companies with no affiliates abroad.
- By interacting with local suppliers, engaging in intra-firm trade and selling to third markets, foreign affiliates act as gateways for the Finnish economy to integrate into global production networks and access new international markets, boosting Finland's exports.

# Finland falls behind its peers in attracting FDI

Finland is considered one of the most open economies in the OECD area. It maintains fewer legal restrictions to FDI than other Nordic-Baltic countries across many sectors of the economy. Foreign investors are attracted by Finland's stable economy and society, strong institutions and low corruption. Access to technology, knowledge and innovation capacity are among the most important factors bringing foreign firms to the Finnish economy.

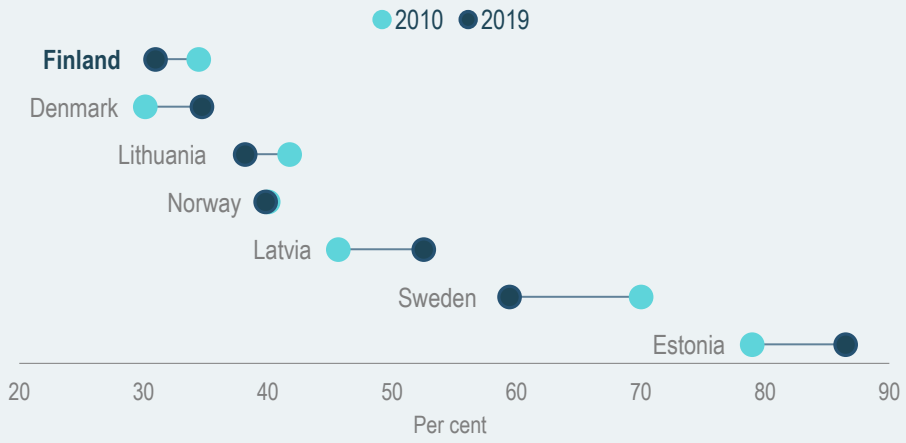
Yet, Finland's performance in attracting FDI lags behind its neighbours, and the gap is widening over time. In 2019, Finland's inward FDI stock was 31% of its GDP – down from 2010 and lower than an average 49% in the Nordic-Baltic economies. Although Finland attracts the highest number of greenfield investment projects in the region, they are, on average, smaller in value than those hosted by Denmark and Sweden. Furthermore, the value of announced greenfield investments into Finland, as well as cross-border Mergers & Acquisitions targeting Finnish firms, declined over the last few years.

The COVID-19 outbreak may pose challenges to Finland's ability to reverse these trends. In line with global forecasts, Finnish FDI flows are expected to decline in the coming years as a result of the pandemic. At the same time, attracting and retaining international investment could be important to sustain the country's economic recovery.

The pandemic may also create opportunities for Finland to attract new FDI, as businesses might rethink the organisation of their operations and might look to relocate their offices. By leveraging its relatively successful response to the health crisis, Finland could further strengthen its reputation as a safe and appealing investment destination. Moving towards recovery from the pandemic, tailoring economic support to the needs of businesses, ensuring the transparency of support measures and continuing to provide up-to-date information on funding opportunities will be important for foreign investors.

**Finland has the lowest inward FDI stock in the Nordic-Baltic region**

FDI positions as % of GDP, 2010 and 2019




Source: OECD International Direct Investment Statistics database (BD4).

## Domestic regulation can influence FDI location by raising the cost of doing business

The domestic regulatory landscape might play an important role in Finland's ability to attract and retain foreign investment. Beyond a country's openness to foreign ownership, domestic policies can indirectly influence FDI through regulation that affects businesses once they have established a presence in the host country, such as rules addressing competition, taxation or use of infrastructure.

While regulation is needed to support legitimate domestic objectives, such as national security or job protection, it may have the unintended consequence of unnecessarily increasing the cost of doing business, and sometimes more so for foreign-owned companies than domestic ones. Reviewing and streamlining inefficient and burdensome policies, snipping red-tape and fostering competition can encourage new international investment and enhance the economic performance of existing players.

# Skilled labour is a key driver of FDI but policy action is needed to address growing skill shortages

Along with access to technology and knowledge, Finland's highly-qualified workforce remains a leading factor that attracts foreign investment into the country. High competence in ICT and health-tech sectors, as well as technical expertise in leading R&D projects, come across as strengths of the Finnish economy.

However, a growing skill shortage makes it difficult for some foreign investors to expand their operations in Finland, particularly in knowledge-intensive sectors. Strict labour market conditions can exacerbate skill shortages by impeding labour mobility. The rigidity of the labour market is reportedly one of the key obstacles to investing in Finland, preventing some firms from growing and creating new jobs.

Excessive bureaucracy for the recruitment of foreign talent from outside the EU/EEA further slows down companies' efforts to mitigate skill shortages, hampering their expansion and internationalisation prospects. With 23 different work-based residence permit types for non-EU/EEA applicants and processing times that have repeatedly exceeded the legal limit of four months, immigration procedures are perceived by many businesses as complex and time-consuming. Labour market tests, used to control that no suitable workforce is locally available for a given position, increase waiting time for applicants. Businesses also considered that recruiting international students completing a university degree or PhD in Finland should be made easier to further retain talent in the country.


Conscious of these challenges, Finland has initiated a number of reforms to streamline the entry of foreign talent. Its cross-administrative Talent Boost programme outlines a wide range of measures that aim to strengthen international talent attraction, retention and integration. However, in view of the country's rapidly aging population, adopting further policy responses that help businesses deal with skill shortages is essential to ensure Finland's continued attractiveness as an investment location. Finland could consider:

1. Continuing planned efforts to improve labour market flexibility. Widening the scope of local-level bargaining in collective agreements would promote greater economic flexibility while safeguarding strong worker protection.

2. Complementing reforms that are already underway to address bottlenecks in the residence permit process, including by reducing the number of permit categories and allocating more resources to speed up the processing of applications.

3. Fast-tracking work-based residence permits for post-graduate students and researchers to support the retention of international talent.

# Streamline processes for new business operations and increase regulatory transparency

Finland maintains few explicit restrictions towards FDI. Due to regulatory harmonisation across the Single Market, trade and investment barriers are particularly low for investors within the EEA, compared to multilateral rules applicable to third countries. Investors from other Nordic-Baltic countries also enjoy the high level of regulatory integration within the region.

Nonetheless, a number of broader regulatory barriers might influence foreign investment decisions to enter the Finnish market. Completing all administrative steps to set up a business takes a relatively long time, and online company registration is only available in Finnish and Swedish. Long processing times to obtain necessary environmental permits, construction permits and approvals of land-use planning can slow down, or undermine, investment projects. The cost of obtaining a construction permit in Finland is also relatively high compared to other Nordic-Baltic countries.

While Finland has well-established and transparent stakeholder consultations for new legislation, its performance in regulatory impact assessment and evaluation of existing regulation remains below the OECD average. Business executives also considered that policy makers might not always be aware of the impact of reforms on companies. For instance, over-regulation in the national transposition of EU directives was perceived to increase compliance costs, putting Finnish companies at a competitive disadvantage in the Single Market.

**CHALLENGES FOR BUSINESS OPERATIONS**

Administrative steps to set up *a business*
**13 days**
but only 4 in Estonia and Denmark

The average processing time of an *environmental permit*
**16 months**

*Construction permit* costs
**0.7%** **of the building value**
the 2nd highest in the Nordic-Baltic region

The following steps could facilitate market entry by foreign investors and promote regulatory transparency:

1. Expedite company registration, reduce administrative burden for companies and promote inclusiveness by adopting digital solutions that allow all businesses to file for company registration on line, also in English.
2. Streamline operational permits to give Finland a competitive edge in fast-growing sectors. Time limits for the processing of permits could be considered. Increased digitalisation of permit processes could further reduce processing times and administrative fees.
3. Keep developing regulatory impact assessment, including by monitoring the national transposition of EU directives.

# Targeted reforms in ICT, transport and logistics can boost competition

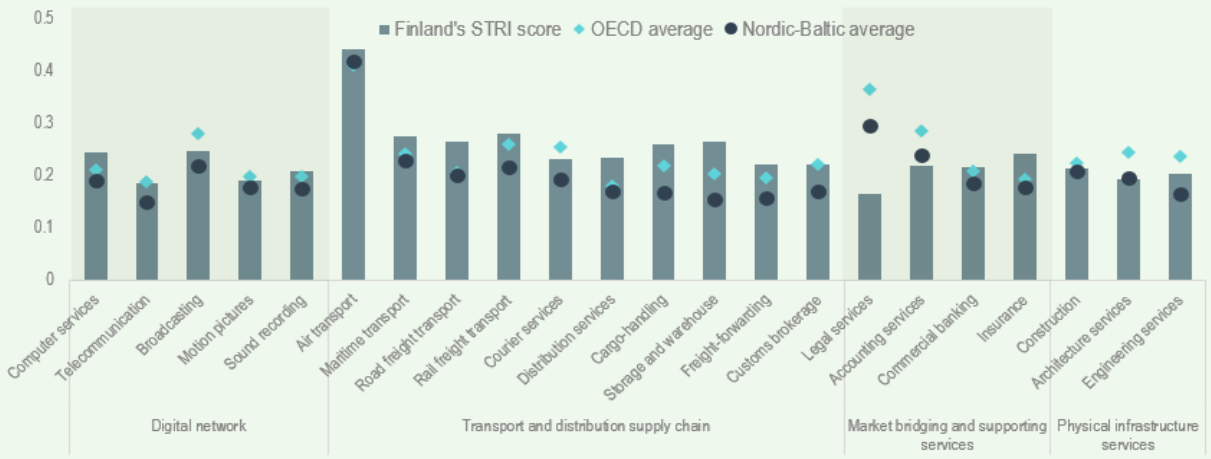
Overall, Finland maintains few regulatory barriers in professional services sectors, which play an enabling role in international trade and investment. Finland's favourable regulatory environment for digitally enabled services, which are increasingly permeating all sectors of the economy, can also attract foreign investors engaged in data and technology intensive activities.

In comparison with other Nordic-Baltic economies, however, there are higher barriers to trade and investment in many Finnish services sectors. Further aligning Finland's regulation with that of its neighbours in sectors of strategic importance would decrease compliance costs for investors and businesses active in several markets within the region and possibly tilt the investment decision in its favour. Facilitating market entry and lowering barriers to competition in critical sectors such as ICT, transport and logistics, which provide essential inputs to downstream industries, can also enhance the overall productivity and competitiveness of the Finnish economy.

Investment in ICT could benefit from additional competition-enhancing regulation to leverage Finland's relatively open environment for companies engaged in digital trade. For instance, while the Finnish telecommunications sector enjoys a good overall coverage of pro-competitive regulation, ensuring a level playing field between newcomers and incumbents, access prices are not regulated in all markets with dominant firms.

Liberalising market access and enhancing competition in transports and logistics sectors can attract new FDI, while also benefitting existing players in the Finnish market and supporting Finland's transition towards climate neutrality. In maritime freight, access to coastal transport between Finnish ports and favourable tonnage tax treatment is largely tied to domestic or EU/EEA ownership of vessels, putting non-EEA foreign providers and investors at a disadvantage. The rail transport sector, in turn, is characterised by little competition. The state-owned enterprise VR holds a large market share in freight transport, and reforms to open the passenger rail transport market to competition have been suspended. In logistics, a lack of mandatory competitive bidding for awarding certain service contracts to logistics providers at ports and airports might affect competition when the number of services providers is limited.

**Finland has more restrictions than most of its neighbours in many services sectors**




Note: The indices vary between zero and one, one being the most restrictive, and cover laws and regulations in force till 31 October 2020.
Source: OECD Services Trade Restrictiveness Index database, 2020.

A number of policy actions could lower barriers to foreign trade and investment in these sectors:

1. Impose price regulation on dominant providers in the remaining telecommunications markets (active wholesale products and high-quality connections) in the form of price caps, cost-oriented pricing or minimum margins.

2. Implement the planned reform that would allow double registration of bareboat chartered vessels in the Finnish ship registry, increasing flexibility for foreign shipping companies. Explore possibilities to attract international providers and investors, for instance by easing the conditions to benefit from tonnage taxation.

3. Carry out the plans to open the rail passenger transport market to competition and continue promoting competition in freight transport. Ensuring access to railway infrastructure and related services for all operators and on equitable conditions will be important to advance competition in a liberalised market.

4. Introduce mandatory public bidding to increase competition for logistics services providers at ports and airports.

# Exploit the full potential of foreign investment in Finland

There could be room to strengthen the positive impact of FDI on the Finnish economy and engage foreign-owned companies more actively in developing business regulation and responding to the broader challenges faced by Finland.

The Helsinki region attracts more than half of foreign investment projects in the country. Although the concentration of FDI in metropolitan areas is common to many economies, a more equal distribution of foreign investment across Finland would contribute to supporting other regions too.

Despite Finland's openness to foreign investment, several business executives reported an unwelcoming environment towards foreign companies. Cultural factors, such as language barriers, may play a role in how foreign investors and foreign talent perceive Finland as a host country. Many foreign firms also wished for better dialogue between policy makers and the business community, with regard to regulation but also collaboration in solving wider societal issues.

Several measures could help Finland exploit its full potential as an investment location:

1. Continue efforts to attract foreign firms to different parts of the country by supporting regional co-operation in investment promotion, increasing the international visibility of Finnish regional industrial clusters and promoting awareness of services that cities can offer to foreign investors.
2. Increase the availability of up-to-date regulatory and administrative information in English for businesses and foreign employees, and keep promoting swift integration of foreign professionals (and their families) through improved language training opportunities.
3. Take additional steps to market Finland as an attractive FDI destination. For instance, engaging government leadership more actively in investment promotion could increase Finland's visibility to prospective foreign investors and convey a welcoming attitude towards foreign businesses.
4. Adopt more extensive communication with foreign-owned businesses in the country and involve the business community in developing a long-term strategy for FDI. Promote co-operation with businesses in addressing societal challenges, such as those brought by the COVID-19 pandemic.

# Steps towards a more attractive investment destination

Finland has already set up initiatives that can improve its general business environment and increase its attractiveness for foreign investors. For instance, as part of its Talent Boost programme, reform efforts are underway to streamline the entry of foreign talent into the country by removing procedural bottlenecks and introducing fast-tracks. Talent Boost also promotes talent retention and integration measures, such as developing Finnish/Swedish language training at workplaces.

Improving the digital infrastructure for companies can reduce their administrative burden. Solutions that would allow for a foreign representative abroad to electronically found a company in Finland have recently been piloted in collaboration with public and private operators, and a planned reform of the Trade Register Act seeks to enable a shift to online services and automatic handling of applications for company registration.

The 2020 National Roadmap for Research, Development and Innovation promotes closer co-operation between research institutions and business community. Indeed, ensuring that technology and knowledge stay competitive is key for Finland to remain an attractive destination for foreign investment in knowledge-intensive activities. Collaboration initiatives between foreign MNEs and local businesses, such as Business Finland's Veturiyritys programme, encourage the exchange of knowledge and new technologies.

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## The Impact of Regulation on International Investment in Finland

The OECD report *The Impact of Regulation on International Investment in Finland* assesses what drives FDI into the country and evaluates how its domestic regulatory environment may facilitate or discourage foreign investment. It underlines potential reform areas and suggests policy actions that could improve Finland's investment climate and contribute to attracting and retaining more FDI, while also strengthening its positive impact.

The report covers the main trends in FDI towards Finland and other Nordic-Baltic countries and the benefits of foreign investment for the Finnish economy. It provides a comparative overview of the regulatory frameworks in Finland and its Nordic-Baltic peers, outlining both economy-wide and sector-specific findings, and explores how changes in regulation are linked to changes in FDI inflows in the region. Foreign investors' views on Finland's business environment complement the findings.

Find out more about the report here: oe.cd/3Er