

GENERAL AGREEMENT ON TARIFFS AND TRADE

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23 December 1965

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REPORT OF THE COMMITTEE ON BALANCE-OF-PAYMENTS RESTRICTIONS ON THE CONSULTATION UNDER ARTICLE XII:4(b) WITH FINLAND

1. In accordance with its terms of reference, the Committee has conducted the consultation with Finland under Article XII:4(b). The Committee had before it a basic document for the consultation (BOP/60 and Corr.1), a Finnish publication entitled "Import System of Finland as applied from 1 January 1966", and documentation supplied by the International Monetary Fund.
2. In conducting the consultation the Committee followed the plan for such consultations recommended by the CONTRACTING PARTIES (BISD, Seventh Supplement, pages 97-98). The consultation was completed on 30 November 1966. This report summarizes the main points of the discussions.

Consultation with the International Monetary Fund

3. Pursuant to the provisions of Article XV of the General Agreement, the CONTRACTING PARTIES had invited the International Monetary Fund to consult with them in connexion with this consultation with Finland. In accordance with the customary procedure the representative of the Fund was invited to make a statement supplementing the Fund's documentation concerning the position of Finland. The statement made was as follows:

"With respect to Parts I and III of the Plan for Consultations, the Fund invites the attention of the CONTRACTING PARTIES to the Executive Board Decision of June 8, 1966 taken at the conclusion of its most recent Article XIV consultation with Finland.¹ At the end of June 1966 the gold and net foreign exchange assets of the banking system amounted to \$182.5 million, \$42.2 million less than at the end of December 1965 and \$126.9 million less than at the end of December 1964. At the present time the general level of restrictions of Finland which are under reference does not go beyond the extent necessary to stop a serious decline in its monetary reserves.

"With respect to Part II of the Plan for Consultations, the Fund again invites attention to the decision taken at the conclusion of its most recent Article XIV consultation with Finland. The Fund has no additional measures to suggest at this time."

¹Reproduced in Annex I to this Report.

Balance-of-payments position and prospects

7. The Committee thanked the representative of Finland for the information which he had provided and congratulated Finland for its bold pursuit of policies designed to deal with its immediate difficulties in a manner which appeared to conform closely to accepted principles for restoration of equilibrium. The reports on reduction and elimination of specific quantitative restrictions and on avoidance of new restrictions were much appreciated, especially in the context of having been accomplished in the face of severe and still continuing balance-of-payments difficulties.

8. A first group of questions put to the representative of Finland concerned the efforts which Finland was making to expand and diversify its export trade by promotion of new export industries; the Finnish representative was also asked whether it was mainly loan capital or also equity capital which was being sought from abroad. In reply, the representative of Finland said that very intensive measures had been taken with a view to developing an "export-mindedness" among Finnish producers. This effort was thought of as a long-term project and it might take a long period of years if Finland was to catch up with other Nordic countries in this respect; it aimed especially at the development of new exports which would supplement the exports of forest products now making up some 70 per cent of Finland's export trade. Special funds had been made available for financing export trade; tax regulations had been amended to make export market research expenses deductible for tax purposes; the Government was also contributing to market research work in other ways. Certain measures which might otherwise have been contemplated, such as export subsidies, or tax relief measures for exporters, had not been pursued as contrary to Finland's various international obligations. But within existing limitations considerable progress had been made, thanks in part to Finland's favourable location with respect to good markets in Sweden and other European Free Trade Association countries.

9. These efforts to promote exports appear more likely to support the balance of payments than a drive to obtain a larger flow of equity capital. In fact, most of Finland's capital inflow other than short-term financing had been long term loan proceeds, the result of borrowing from private investors and banking and other institutions. Because of its remoteness from the centre of Europe, Finland could not hope to attract much direct foreign investment, as investors tended to prefer more central locations for industrial ventures. Even within EFTA, Finland's geographical position was somewhat peripheral. In any case, Finland's legislation afforded liberal treatment to foreign investment and the laws were applied in a very liberal spirit in the hope that foreign direct investment might be forthcoming in larger amounts, but it would not appear realistic to anticipate such substantial inflows as those which in some other Western European countries had provided an important contribution to the balance of payments.

10. Members of the Committee expressed their appreciation for this account of ways in which export production is being helped to find new markets and adequate financing, though they felt that there might also be an additional problem of stimulating and directing production itself into products suitable for "new" export. It was recognized however that bringing about industrial expansion might be difficult at a time when a generally tight money policy was being pursued. The representative of Finland agreed in general terms, but emphasized that the credit squeeze in Finland does operate in a selective way, tight as it is, so that the Bank of Finland, for example, rediscounts commercial bank loans which represent advances to finance new exports with good prospects; foreign export bills issued by foreign importers are also rediscounted where this helps to finance new exports. In addition, there is an institution called Export Credit Ltd., which has funds for financing export trade, and also an Export Credit Guarantee Corporation similar to such institutions in other European countries. All in all, much more effort is being expended to create new exports than to promote pulp and paper exports if the relative marginal export increases are taken into account.

Alternative measures to restore equilibrium

11. The representative of Finland was asked whether the budget to which he had referred as "restrictive and balanced" was expected to be in balance in 1967. In reply the representative of Finland said that this was indeed to be expected. The budget proposal which had been presented to the Finnish Parliament, as shown in one of the background papers before the Committee, showed substantial increases in revenues expected from various taxes and charges that would bear heavily on every resident of Finland in the year ahead. These proposals, which are not likely to undergo any major change, will, when adopted, mean that for the first time in some years fiscal policy will join monetary policy in supporting the painful but necessary process of restoring equilibrium through restraint of consumer and investment spending.

System and methods of the restrictions

12. Members of the Committee expressed particular gratification at the news that Finland's last bilateral payments agreement with a country not in the State-trading group is on the way to termination. Whilst recognizing that special circumstances exist in regard to trade under remaining bilateral agreements, they expressed the hope that reasonable steps would be considered to minimize reliance on such agreements, especially those of a strictly bilateral balancing type. In answer to a later question, the representative of Finland stated that he did not know of any element in Finland's import system which either favoured multilateral as compared with bilateral countries or had the opposite effect.

13. Several members inquired concerning the import régime affecting purchase of passenger cars. As explained by the representative of Finland, the importation of automobiles and spare parts had been freed of restriction and there was no discrimination as to sources. Finnish consumers might have preferences for one make of car or another but that was not a matter in which the Government was concerned. This liberalization represented a voluntary unilateral action on Finland's part, as Finland had exceeded its EFTA commitment considerably.

14. The representative of Finland noted that it was true however that taxes on automobiles had gone to high levels, and gasoline taxes were also high. Even so, imports recently had amounted to some Fmk 500 million annually, or about 6 per cent of total imports, and demand appeared to be continuing to increase. The heavier taxation had however tended to a certain extent to slow down the growth of demand for the time being. Finland hoped on the other hand that these measures would not be of indefinite duration.

15. In answer to a further question, he added that a slight degree of difference did exist in the hire-purchase arrangements in effect with respect to automobiles from Eastern sources. Terms for instalment purchases of cars from the multilateral area were somewhat less favourable for the purchaser, but he did not think that this matter was of great importance. With respect to the manner in which excise taxes on automobiles were applied, about which a question was also asked, he explained that the progressively heavier rate of taxation of more expensive automobiles corresponded to Finland's fiscal and balance-of-payments needs. As of possible interest to suppliers of larger cars, he added that a large group of buyers of such cars in Finland, the taxi-drivers, could continue to purchase their vehicles exempt from the higher taxes, as the tax was refunded when the vehicle was used for professional purposes. This applied also to purchase of vehicles for other professional purposes; ambulances, delivery vans actually used for the transportation of goods, etc. were free of tax. He noted that another feature of the situation which might well account for some decline in sales of more expensive cars was the very high cost of petrol, on which Finnish taxes were now nearly the highest in Europe.

16. Members of the Committee were not entirely satisfied that Finland's system of taxation of automotive vehicles was entirely equitable. It was felt that in the stringent situation confronting the country, it might be acceptable to impose a straight ad valorem tax rather than a uniform charge irrespective of size of vehicle, but that to impose a higher rate of tax on higher priced vehicles was excessive, especially when this meant that the tax on a vehicle with a c.i.f. duty-paid value of \$4,000 was at the rate of 132 per cent ad valorem whilst a vehicle valued at \$1,000 on the same basis paid only

80 per cent on its lower value. It did not seem clear, either, that the discrimination in the matter of hire-purchase terms was necessarily of little consequence in the purchaser's decision on choice of vehicle. The representative of Finland was asked to note the points that had been made and to convey to his Government the request that the discriminatory features in these arrangements be modified or eliminated, and he agreed to do so.

17. With regard to the State-trading sector of Finland's system, it was asked how the alcohol monopoly was operated since there were from time to time complaints that it might operate to keep imports out of the Finnish market; this was thought to apply for instance, especially to beer. The representative of Finland said that the alcohol monopoly purchased purely on commercial and social considerations and according to consumer demands.

18. In reply to a question concerning the effects of bilateral payments agreement commitments on imports of wheat from other sources, the representative of Finland said that his country was nearly self-sufficient in wheat so that there was no very large market for imports. There were also certain commitments to purchase from bilateral countries which Finland wanted to fulfil. Beyond that, the policy of the State Granary was based on commercial considerations and the only restrictions in force were the provisions of the bilateral agreements. The representative of Finland was asked to convey to his Government members' interest in the liberalization of these restrictions.

19. A question was also asked concerning instructions which were believed to have been issued in February 1966 concerning procurement by State institutions. In reply the representative of Finland indicated that this internal governmental circular was a matter which could easily be misunderstood abroad. In fact, the circular had only reminded Finnish State institutions that in their purchasing operations they should always seek bids from Finnish as well as foreign suppliers. So far from requiring that any preference be given to Finnish sources, Finland found that it sometimes happened that Finnish suppliers had actually been overlooked when bids had been sought by State institutions. It was only to require that Finnish sources be asked to bid that the circular had been issued. Now, as before, no preference was accorded to local suppliers. Members of the Committee suggested that if there was need for such a circular, this might suggest need for more publicity for notices that bids were being solicited. The representative of Finland believed that this had been taken care of, at least for major bids and emphasized that Finland had benefitted substantially from the growing practice of international competitive bidding.

20. With respect to the future, members asked for somewhat more detail regarding the situation that was expected to prevail as from 1 January 1968; they inquired specifically whether all quantitative restrictions from multilateral countries were expected to have been abolished by that time. The representative of Finland said that this was not the case. The programme of quota elimination which Finland had undertaken within EFTA did not include all quantitative restrictions in force, and it had always been recognized in EFTA that a hard core of restrictions would remain after that programme had been carried out. Approximately eleven global quotas would probably remain in force after the EFTA liberalization programme had been completed and further consideration would have to be given to the question as to what liberalization measures could be made effective in that sector.

Conclusions

21. Members of the Committee again thanked the representative of Finland for the full information which had been given and reiterated their appreciation for the very great progress which Finland had made in relaxation of its import restrictions in a difficult situation. They welcomed the arrangement under which Finland's last remaining bilateral payments agreement with a country outside the State-trading area was expected to terminate within a year or so. They were also gratified that certain other elements of discrimination had been removed from the import régime. They looked forward to further relaxation and removal of restrictions to all contracting parties without discrimination among them. Whilst they had asked at a number of points that consideration be given to modification of particular regulations, they were especially anxious that this should not obscure their overall satisfaction with the main line of development of Finnish commercial policy.

ANNEX I

INTERNATIONAL MONETARY FUND EXECUTIVE BOARD DECISION
TAKEN AT THE CONCLUSION OF THE FUND'S CONSULTATION
WITH FINLAND ON 8 JUNE 1966

1. This decision is taken by the Executive Directors in concluding the 1965 consultation with Finland, pursuant to Article XIV, Section 4 of the Articles of Agreement.
2. As a result of a smaller growth in exports and in fixed investment, the growth rate of the Finnish economy slowed down in the second half of 1965 and the employment situation weakened. The real gross domestic product in 1965 was 5 per cent higher than in 1964 compared with an increase of 6 per cent between 1963 and 1964. In 1965, wages and costs rose considerably less than in the previous year and the cost of living rose by 4 per cent. Wage rates are estimated to be higher by some 4 per cent in 1966 than in 1965, only slightly more than the expected gain in productivity in manufacturing industry.
3. Although the growth of the value of commodity imports declined from 24.6 per cent in 1964 to 9.3 per cent in 1965, the deficit on the current account of the balance of payments rose from \$175 million in 1964 to \$187 million as a result of a slower growth in the value of commodity exports and a decline in the net receipts from services. At the same time the net inflow of official and long-term private capital declined substantially and the current account deficit was thus, to a great extent, financed by a running down of the foreign exchange reserves. At the end of 1965 the net external assets of the banking system (including the gold tranche position in the Fund) totaled \$239 million or \$87 million less than a year earlier, almost the entire reduction taking place in net convertible currencies. Reserves continued to decline in the first quarter of 1966.
4. In an effort to bring the current account deficit of the balance of payments into a more appropriate alignment with Finland's borrowing possibilities, the Finnish authorities took steps in 1965 to moderate the growth of credit and imposed tighter conditions on installment purchases. The banking system's claims on the private sector rose by 12.1 per cent in 1965 compared with 13.5 per cent in 1964. Efforts were also made to restrain the growth of government expenditure and the budget deficit on current and capital account was reduced from Fmk 410 million in 1964 to Fmk 119 million in 1965. However, it appears that this deficit, on the basis of the approved budget, will rise again in 1966. In the light of this situation the monetary authorities continued their policy of credit restraint.

The Fund considers that the budgetary position should be strengthened in order to prevent an undue tightening of monetary conditions, with undesirable consequences for investment and future growth.

5. Finland has continued to reduce restrictions and discrimination affecting imports except that free licensing of imports of passenger cars has been curtailed in the first half of 1966. The Fund welcomes the measures of liberalization taken thus far, and considers that continued progress in this direction will facilitate the sound growth of the Finnish economy. The Fund notes that the Finnish Government has expressed its readiness to cooperate fully in any efforts to eliminate the remaining two bilateral payments agreements with Fund members.

ANNEX II

OPENING STATEMENT OF THE REPRESENTATIVE OF FINLAND

When I looked through, before starting to write an outline of the matters requiring some elucidation at the outset of our present meeting, last year's statement presented in this very same forum, I noticed that my predecessor made it quite clear, at that time, that Finland was facing "a very serious balance-of-payments crisis".

I am sorry to report that these expectations have, in the meanwhile, proved to be only too justified. We are now right in the middle of an extremely serious balance-of-payments crisis. I do not wish to dramatize this too much, but the fact is that since the beginning of 1965 Finland has lost over one half of its net foreign exchange assets. At the beginning of that year, Finland's foreign exchange assets - taking the Bank of Finland assets and deducting from them the net indebtedness of the so-called authorized banks, i.e. banks authorized to deal in foreign exchange - were Fmk 945 million, or about \$295 million. The corresponding figure for the end of October was Fmk 412 million or less than \$130 million. While more recent figures for the authorized banks are not available, it is known that the Bank of Finland net reserve has further declined by about Fmk 40 million between the end of October and the statement day, 23 November.

After these dismal statistics, I take pleasure in being able to point out certain factors which might give reason to some better hopes for the future. The external liquidity problem, really, has become, in the past year and a half, a truly national problem in Finland. This is not only evidenced in the extremely strict monetary policy, but also in the fact that the Government budget for 1967 is definitely an "austerity budget", characterized by severe tax increases. As the present Government, which came into office last spring, commands a three-quarters majority in the Parliament, it is reasonably likely that the budget proposition will be accepted without major amendments.

The members of the Committee will surely appreciate the fact that a restrictive and balanced budget, together with an extremely tight monetary policy, will carry as a necessary consequence a decline in the economic growth rate of the nation during the coming year. This is the price which we shall have to pay - and which we are willing to pay - in order to bring our balance-of-payments deficit to such a level that it could be managed with normal

foreign long-term borrowing. You all know how much tighter the international capital markets have become since the beginning of 1965. As was noted in the preceding consultations in this Committee, Finland's ability to borrow on the long-term international capital markets has severely declined. Against a balance-of-payments deficit of the order of Fmk 600 million in 1965, we were able to borrow long-term external funds only to the amount of Fmk 161 million, or about \$50 million. This is less than one quarter of the deficit, with the rest being financed, as I mentioned before, from the foreign exchange reserves and by short-term foreign borrowing - the latter being a necessary but by no means prudent way of financing balance-of-payments deficits. Long-term borrowing abroad will, in 1966, be of roughly the same magnitude as in 1965, since no revival for Finnish borrowing on international capital markets can be expected.

It was explained already in last year's consultations that the Finnish authorities, in their measures for dealing with the balance-of-payments crisis, had chosen the much more difficult road of indirect and slower-working measures which affect the total demand, and that they were determined to avoid the easy but at the same time harmful measures of quantitative restrictions, tariff increases, surcharges and so on. Our authorities have been criticized at home for this approach, but we believe it to be the correct one, especially regarding our ties to the GATT and the European Free Trade Area.

We are thus fairly confident that, through an austerity programme reflected in the budget and in the monetary policy, the extremely large balance-of-payments deficits of 1964 and 1965 will be brought down to manageable levels. In this, the policies of the Finnish authorities would be helped greatly by an easing of the international capital market. Some optimists predict that this is forthcoming, but these assurances are not sufficiently reliable to be used as a policy basis. Therefore, the economic policy of the authorities will have to be based on strict austerity, largely due to the fact that the "international margin", i.e. the external liquidity situation, in our case is extremely limited in comparison with other Western European countries. With reserves of less than Fmk 400 million, one cannot manage current account deficits of Fmk 600 million. We know of countries which have managed with even negative reserves, but they have had better access to short-term credit facilities than we have.

I should like to make one further point, since the question of our last remaining bilateral agreement with a member of the International Monetary Fund - after our trade with Turkey and Greece was put on a multilateral basis as mentioned in the basic document distributed - has been frequently discussed

in these consultations. After the Annual Meeting of the Fund in September, discussions were conducted between the Colombian and Finnish authorities which resulted in an understanding that this bilateral payments agreement would be eliminated in about one year's time. I hope that this information will please members of the Committee.

It is a source of genuine satisfaction to me, Mr. Chairman, that I can conclude by pointing out that - despite the very real balance-of-payments difficulties which have been shortly touched upon - Finland has been able to go on with her appointed task of gradual abolition of the limited number of quantitative restrictions still in force. I do hope that the members of this Committee will fully appreciate the fact that the further deterioration of our balance-of-payments position has not been allowed to interfere with this process. It should also be stressed that, as I shall shortly explain in somewhat more detail, my Government has the intention of suppressing, at the beginning of next year, a further quite large number of outstanding global quotas.

It might be remembered that four quotas were totally abolished in the course of the year 1965 and twelve others partially liberalized. The beginning of 1966 was marked by the suppression of fifteen more quotas, covering 174 tariff items and sub-items and representing a trade value of Fmk 75 million, calculated on the basis of the actual 1964 f.o.b. import figures.

A new decisive step in this direction - based on Finland's undertakings within the European Free Trade Association - will be taken at the beginning of next year. It is the intention to abolish, on that date, thirteen more global quotas including, for example, a large quota for machines and appliances as well as television and radio sets. This would mean the further suppression of 144 tariff items and sub-items, covering some Fmk 135 million according to 1965 import statistics. The corresponding amount on the basis of this year's global programme figures is Fmk 168 million.

It should also be noted that the process of suppression was and will be accompanied by a substantial enlargement of the remaining quotas.

I think it can be said that the expected new measures will constitute a major step towards our ultimate goal: the total elimination of global quotas. If the plan is approved, the number of remaining, enlarged quotas will be twenty-one, with an approximate trade value of Fmk 300 million, and we sincerely hope to be able to abolish a substantial part of those residual quotas at the outset of the year 1968.