

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

BOP/R/61

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Limited Distribution

1972 CONSULTATION UNDER ARTICLE XII:4(b) WITH FINLAND

Report of the Committee on Balance-of-Payments Restrictions

1. In accordance with its terms of reference, the Committee has conducted a consultation with Finland under paragraph 4(b) of Article XII. The Committee noted that the previous consultation with Finland under the same provisions had been held in March 1970 (see BOP/R/44). In conducting the consultation, the Committee had before it a basic document supplied by the Finnish authorities (BOP/123), a background paper provided by the International Monetary Fund, dated 7 June 1972, and the text of a decision of the Executive Board of the International Monetary Fund taken on 1 March 1972.

2. The Committee generally followed the plan for such consultations recommended by the CONTRACTING PARTIES (L/3388, Annex I). The consultation was held on 20 June 1972. This report summarizes the main points of the discussion.

Consultation with the International Monetary Fund

3. Pursuant to the provisions of Article XV of the General Agreement, the CONTRACTING PARTIES had invited the IMF to consult with them in connexion with the consultation with Finland. Upon the invitation of the Committee the representative of the IMF made a statement, as follows:

"The Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of March 1, 1972 taken at the conclusion of the most recent Article XIV consultation with Finland particularly to paragraphs 3 and 6 which read as follows:

'3. The value of exports, which rose sharply in 1969 and 1970, rose only slightly in 1971, partly because of the strikes and partly reflecting weaker demand conditions. The value of imports rose somewhat more strongly. As a consequence, the current account, which showed a surplus of \$20 million in 1969, showed a deficit of \$239 million in 1970 and about \$340 million in 1971. Reserves, which had increased sharply in the previous three years, continued to rise largely as a result of long-term borrowing. At the end of December 1971 the gold and foreign exchange reserves of the Bank of Finland amounted to the equivalent of \$774 million.'

'6. Following action by the U.S. authorities in the exchange field in August 1971 the Finnish authorities along with the authorities of many other Fund members no longer undertook to apply the minimum buying rates previously established for the U.S. dollar, and in December a central rate for the U.S. dollar was established of Fmk 4.10 per US\$1, representing a 5.6 per cent depreciation from the par value of the markka expressed in terms of gold. This action was appropriate in the light of Finland's balance of payments position. It should permit the authorities to preserve the gains that have been made in the liberalization of trade and payments and the Fund hopes that efforts will be made to achieve further reduction in the reliance on external restrictions."

Opening statement of the representative of Finland

4. In his opening statement, the text of which is contained in the Annex, the representative of Finland outlined developments in the Finnish economy and in the balance of payments in recent years. It was recalled that when the last consultation was held in 1970, Finland's balance of payments had been developing favourably, reflecting the effects of the 1967 devaluation and the rapid growth of the world economy. Since then, while further progress had been made in strengthening the Finnish economic structure through diversification, coupled with incomes policies to safeguard stability, the balance-of-payments position had undergone a change for the worse. This deterioration was partly caused by special factors, for which appropriate allowances might be made, but mainly reflected the vulnerability of the Finnish economy to changes in the level of economic activity in Finland's main trading partners. The value of exports, which had risen sharply in 1969 and 1970, had shown only a marginal improvement in 1971, while imports rose somewhat more strongly. As a result, the current account, which had shown a sizable surplus in 1969, had reverted to a deficit in 1970, which had grown rapidly in 1971. Reserves, which had increased sharply in the previous years, had continued to rise largely as a result of long-term borrowing. The availability of long-term capital was, however, likely to become inadequate.

5. While 1970 had been a year of boom, the growth in GNP in 1971 was by 1.3 per cent only, which was the lowest since 1958. The slowdown was accentuated by prolonged strikes in the metal and construction industries at the beginning of the year. Unemployment also showed a tendency to rise.

6. With a view to stimulating growth and employment in the latter half of 1971, various fiscal and monetary measures had been adopted, with particular emphasis on diverting funds from consumption to investment. These measures included a supplementary turn-over tax, the raising of interest rates, the release of counter-cyclical funds for investment purposes and enlarged credit quotas for commercial banks. In order to avoid a serious weakening of the competitiveness of Finnish exports, the "central rate" adopted in the context of the general currency realignment in December 1971 had been so set as to appreciate the markka in terms of US dollar by no more than 2.4 per cent.

7. As a result of these measures, the Finnish economy had shown some improvement in the first half of 1972. Further improvement was expected when eventually exports overtook imports and the deficit on current account was reduced. The growth in GNP during 1972 was expected to be around 3.5 per cent as against 1.3 per cent last year.

8. In conclusion, the representative of Finland stressed the need for continued vigilance with regard to developments in the balance of payments, which remained an important constraint on all economic policies. The continuation of the balance-of-payments restrictions was still necessary under present balance-of-payments conditions, especially for three reasons. First, the process of structural transformation aiming at a better balance between supply and demand was still in progress and enlarged imports of necessary inputs were likely to exercise pressure on Finland's balance of payments. Secondly, imports of fuels and raw materials under bilateral arrangements had to be maintained which had permitted a greater degree of liberalization of multilateral imports into Finland than would have otherwise been possible. Thirdly, current account balance was not likely to improve substantially in the course of 1972 and 1973.

Balance-of-payments position and prospects

9. Members of the Committee expressed appreciation for the concise and clear opening statement which provided a useful start point for the discussion. They noted that the current account position of Finland had significantly deteriorated in the past two years owing to general cyclical conditions at home and abroad and other special factors. However, they expressed the view that the current account deficit in these years was largely attributable to factors which were unlikely to be recurrent, and noted that the deterioration on current account was more than compensated by the capital account surplus, which had led to a steady increase in reserves. Coupled with the benefits of the recent currency realignment, this improved reserve position should help make it possible for Finland to reduce further its reliance on import restrictions.

10. Invited to comment on future prospects of the Finnish balance of payments and the likelihood of import liberalization being resumed and accelerated in the near future, the representative of Finland said that while he would not disagree with this prognostication, and shared the hope that the Finnish balance of payments would further improve along with the recovery of the world economy, he was not in a position to say at what precise time the improvement would be sufficient to allow the removal of the remaining restrictions. Finland's past performance in this regard should, however, be sufficient evidence that the Government had no desire to desist from taking such action as soon as, and as far as, the balance-of-payments position permitted. At present almost 95 per cent of Finnish imports from multilateral sources had been freed from quantitative restrictions. There were only a few agricultural products, certain mineral fuels on which restrictions were still maintained.

11. In response to a member's observation that the present current account deficits were more than covered by inflow of long-term capital, the representative of Finland recalled that while long-term capital was pivotal in financing the current account deficit of 1971, the 1970 deficit had been met largely by short-term indebtedness. Recently there had been some improvement in the structure of Finland's foreign assets and liabilities.

12. Invited to comment on the relative importance of the effects of the devaluation and cyclical factors on the Finnish balance of payments, the representative of Finland pointed out that it was not possible to distinguish the effects of these different factors. It was clear, however, that the significant cost pressure resulting from substantial wage promises had nearly offset the beneficial effects of devaluation so that any future improvements would largely reflect the up-turn of external demand for Finnish exports. In this connexion, the IMF representative noted that the persistent deterioration in Finland's trade accounts during the 'sixties had not so much been caused by any competitive weakness of Finnish products, as reflected the tendency for Finnish exports to grow less rapidly than those of other OECD countries. The elasticity of demand for typical Finnish exports was lower than that for the exports of the European countries, as the former still comprised a high proportion of forest products. This proportion had declined from 75 per cent in 1960 to

56 per cent in 1970, still a relatively high level. The situation was likely to continue unless further measures were taken to diversify the export structure. The representative of Finland, while agreeing with this general analysis, pointed out that the change in the ratio between forestry and other products had been quite rapid, showing that diversification was well under way.

13. In reply to a question whether the traditional trade links with the United Kingdom would remain unaltered after it joined the Common Market, the representative of Finland said that the basic policy of the Government was to preserve such links to the fullest extent possible.

14. A member of the Committee drew attention to the efforts made in Finland in recent years to deal with the problem of over-production in the agricultural sector, and enquired about the rate and magnitude of movement of labour from farms to cities. In reply, the representative of Finland observed that in 1950, about 46 per cent of the people had been employed in agriculture and forestry. This ratio had come down to 35.5 per cent by 1960, and further to 20.2 per cent by 1970. Despite a considerable fall in the labour force working on the farms, agricultural production had continued to rise. The Finnish Government had resorted to other measures to curb agricultural production. Among these were the soil bank system; reforestation; changes in consumer price ratios between butter and refrigerated margarine; specific legislation to curb the production of pork and eggs; early retirement and pension scheme for farming personnel and lump purchases by the State. The difficulty in Finland's structure of production was that surpluses emerged in sectors which were not effectively controlled.

Alternative measures to restore equilibrium

15. In discussing internal measures to stabilize the economy a member of the Committee referred to Finland's incomes and price policies and invited comment on the Finnish experience. The representative of Finland indicated that following the devaluation of the Finnish markka in October 1967, income, wage and price developments had been regulated by comprehensive voluntary income agreements between different economic groups. During the first years stability in incomes and prices had been achieved by the abolition of practically all prevailing links of incomes with prices. This stability could not, however, be maintained in 1971 when import prices increased substantially and wage adjustments became more frequent. A new incomes agreement, the fourth since devaluation, had been concluded for the period from 1 April 1972 to 31 March 1973.

16. In reply to questions concerning the Finnish supplementary sales tax, the representative of Finland explained that this had been imposed for the purpose of discouraging private consumption of durable goods. Although its incidence had fallen primarily on imported goods, its purpose had not been to restrict imports. In reply to a question the representative of Finland said that he did not believe that the tax, which had expired at the end of 1971, would be reimposed.

17. In discussing the import equalization tax, members of the Committee recalled that while this was stated by the Finnish authorities to be a device to compensate domestic producers for the occult burden of the present sales tax system, discussions in the Industrial Committee on non-tariff barriers had shown that it might place an additional incidence on imports in a manner incompatible with the provisions of Article III of the General Agreement. They would, therefore, like to be assured that the tax would not be continued beyond 1972. The representative of Finland explained that the equalization tax applied to about 60 per cent of total imports. The use of this device represented a step towards the adoption of the value-added tax, which had been adopted by many other European countries but which, as yet, had not gained general acceptance in Finland. He could not say at present whether and when it could be terminated, or whether additional products would be exempted.

18. The representative of the United States, with reference to past discussions on this subject, again raised the question of Finland's motor vehicle tax which was progressively weighted against medium-sized and large vehicles and was levied on c.i.f. value plus duties and other levies. The combined effect of various taxes normally raised the retail price of an American car in Finland to 2.7 times over the c.i.f. value. United States exports of motor vehicles to Finland had fallen from \$5.8 million in 1964 to \$0.8 million in 1968. They had showed only a slight recovery to \$2.1 million in 1970, but this was not indicative of any long-term trend, but reflected only a very strong import demand of Finland in that year. The United States Government regretted that the Finnish Government had not responded positively to its repeated representation that this tax be reduced and that the partial exemption favouring of small cars be extended so as to eliminate the discrimination against larger cars of the type exported by the United States. In addition, the instalment credit regulations in Finland discriminated against passenger cars imported from multilateral trade sources and in favour of bilateral sources; down-payments of 60 per cent with a credit period of nine months was prescribed for vehicles imported from the former sources as against 40 per cent and eighteen months for those from the latter. The United States did not believe this discrimination was consistent with Article I. As his country produces similar types of automobiles, the representative of Canada associated his delegation with the concern expressed by the representative of the United States.

19. The representative of Finland agreed that the system of c.i.f. valuation placed far-away countries in a slight disadvantage but pointed out imports of cars from the United States had shown an increase of 79 per cent in 1970 over the preceding year. As regards instalment credit regulations, this somewhat insignificant differentiation should be viewed in the context of Finland's special payments relations with these countries.

Administration and effects of the restrictions

20. One member of the Committee noted that, apart from mineral fuels, only about 1 per cent of Finland's imports from the multilateral trade area were subject to licensing control and that these restrictions could therefore have but very limited significance for the balance of payments. The composition of the restricted list strongly suggested that the controls were maintained for other purposes. He enquired whether the Finnish Government had considered disinvoking Article XII and abolishing the restrictions. In reply, the representative of Finland referred to his earlier statement that at present total holdings of foreign exchange reserves equalled to no more than the value of eleven weeks' imports and were not at a comfortable level. Import restrictions on agricultural products were indeed also warranted by structural problems in this sector.

21. The representative of the United States suggested that further progress in the direction of reducing quantitative restrictions might begin with the removal of restrictions on canned fruits and fruit juices, which were of considerable export interest to his country. The Finnish representative replied that imports of canned fruits and juices were not subject to any effective restriction as the requisite import licences were freely issued upon application; about 97 per cent of these products were imported from multilateral sources.

22. In reply to a question on whether Finland would apply its import restrictions without discrimination if and after it entered into a free-trade arrangement with the EEC, the representative of Finland assured the Committee that the multilateral treatment would be maintained.

23. In answer to another question regarding Finland's experience with the freely convertible currency arrangements which it had entered into with Poland and Czechoslovakia, the Finnish representative mentioned that the experiment had so far not led to any increase in trade.

24. A member noted that between 1970 and 1971, Finland's imports from the multilateral area had fallen from 79.8 to 77.4 per cent of total imports, while those from bilateral sources had risen from 16.3 to 18.4 per cent of total imports. Invited to comment on the factors behind this development, the representative of Finland stated that the rise in the value of Finnish imports from bilateral trading sources in 1971 was mainly due to an increase in the volume and price of mineral fuel imports.

Conclusions

25. The Committee expressed sympathy for the difficult economic situation that Finland had again faced in the past year, but recognized that Finnish reserves had increased substantially due to a rise in capital imports. It also stated that the significant current account deficit had been caused by special factors and that the expected recovery of the world economy and the recent currency realignment should help to strengthen demand for Finnish exports. The Committee therefore expressed the hope that, as a result of these factors and the measures taken to diversify the Finnish economy, Finland would continue to reduce its reliance on import restrictions.

26. The Committee also urged the Finnish Government to give sympathetic consideration to the various representations made by other delegations in the course of this consultation concerning their particular trade interests or concerning particular aspects of the Finnish import control system.

ANNEX

Opening Statement by the Representative of Finland

Our preceding consultation two years ago took place against the background of favourable balance-of-payments developments following the 1967 devaluation and the upturn of economic growth abroad. However, even then we brought forth the structural weaknesses of the Finnish economy as being still considerable despite the fast diversification of output and exports in the past decade. We also stressed the cyclical vulnerability of the external position resulting from these structural factors. Even so, events during 1970 and 1971 indicate that we were not cautious enough. The current account, which in 1969 had shown a slight surplus, turned negative early in 1970, and for the year as a whole the deficit amounted to 1.0 billion markkas. In 1971 the deficit reached 1.4 billion markkas corresponding to some 3 per cent of gross domestic product. Although the deficit was to some extent inflated by special factors, the fact remains that there is a large underlying deficit.

I would like to proceed by giving an account of the developments that have preceded the present situation, which is characterized by the expectations of an upturn but as yet also by a very low level of economic growth, a rising rate of unemployment and, of course, the considerable trade deficit.

In the Finnish economy 1970 was a boom year, during which fixed capital formation and stockbuilding grew quite rapidly. The volume of total output rose at an annual rate of more than 6 per cent throughout the year. The degree of capacity utilization remained high despite large additions to capacity. Employment developed favourably, and the unemployment rate averaged less than 2 per cent. In contrast to developments in most other countries at the time, cost and price levels were relatively stable.

During 1970, the rate of increase of the volume of exports slackened considerably, but the rise in export prices to some extent compensated for this. The slower growth in exports reflected supply difficulties in certain sectors as well as a weakening of expansion in foreign demand. Imports grew considerably faster than exports, the result being a large deficit on trade account.

In 1971, following two years of rapid expansion, the Finnish economy met with a recession that was deeper than in most other industrial countries. Aggregate output only grew by 1.3 per cent, the lowest figure recorded since 1958. The main factor responsible for the low growth rate was unexpectedly fast slackening in export demand. Because of impaired demand prospects, the emergence of substantial excess capacity and a tightening of business liquidity, private investment only grew by one per cent year-on-year, and during the late part of 1971 it was lower than a year before. These adverse cyclical developments were amplified by special factors such as work stoppages in the metal and engineering industries and in the building sector early in the year. The employment situation

remained comparatively good in average terms, although there was continuous rise in the unemployment rate. Furthermore, the rise in prices and costs accelerated as a result of both external and internal influences.

Considerable concern about the size of the current account deficit developed during the first half of 1971. As the growth and employment situation also deteriorated more rapidly than expected, the policy mix was designed so as to switch demand away from consumption into investment rather than restrain overall demand. The measures taken included a supplementary turnover tax, the raising of interest rates as well as measures to secure adequate credit supply for investments.

In the latter half of 1971, as expectations improved, the emphasis of economic policies was, by means of monetary and fiscal measures as well as considerable long-term capital imports, laid more strongly on the stimulation of growth and employment. The counter-cyclical funds accumulated during the previous boom were released and the Central Bank enlarged its credit quotas for commercial banks and also lowered interest rates. The supplementary turnover tax on consumer durables introduced earlier in the year was not renewed after year end.

The rate of increase in imports slowed down in 1971 but still exceeded the growth rate of exports, and thus the high current account deficit emerged. By volume both exports and imports of goods in fact fell slightly. In addition to rising cost pressures the outlook in foreign trade was clouded by the uncertainties surrounding the international monetary system as well as the European market constellation. In order to prevent a serious deterioration of the competitiveness of Finnish industry, the central rate set in connexion with the general currency realignment in December was not allowed to appreciate the markka in terms of the US dollar by more than 2.4 per cent.

In the first half of 1972 the Finnish economy has improved somewhat. The cyclical upturn is expected to strengthen in 1973. Exports are forecast to be the main expansionary element in 1972 with the volume of investment declining and that of consumption advancing only moderately. Imports are likely to increase in value more slowly than exports with a resulting slight decrease in the deficit on current account. Gross domestic product is estimated to expand by 3 1/2 per cent. Despite the acceleration of output unemployment is expected to be on the increase until early 1973.

Costs and prices are likely to rise somewhat more slowly than in 1971, but still at a substantial rate. The improvement in the growth outlook has changed the climate of economic policy. While economic policies are still directed at stimulating growth and employment, increasing attention is given the necessity to maintain stability in later phases of the cyclical upturn. As yet, however, monetary and fiscal expansion has been continued and bank liquidity is forecast to remain fairly easy during the remainder of the year. This being the case, the Central Bank also decided to terminate as of 1 June 1972 the restrictions on short-term import credits introduced in late 1970.

As evidenced by the fact that the current deficit in 1971 reached a level of 3 per cent of GDP, the balance of payments has since our last consultation developed much more unfavourably than was expected. Moreover, a considerable underlying deficit is forecast to remain in the foreseeable future. As the availability of capital in foreign markets undergoes large and often sudden variations, great caution is needed in the management of balance-of-payments policies. This factor is strikingly illustrated by the rather extreme fluctuations in capital market conditions abroad in recent years. The one billion current account deficit of 1970 had to be financed by means of a heavy increase in short-term indebtedness. In 1971, on the other hand, supply conditions improved and it was possible to finance the current deficit by means of long-term capital imports.

The availability of long-term capital in 1972 has so far remained fairly good. It seems probable, however, that the main industrial economies will, in response to the upturn in business conditions, increase their demands on the market. This would have the effect of limiting the availability of long-term funds.

The Bank of Finland has, in order to achieve a somewhat more comfortable reserve position, encouraged capital imports over and above the financing of the current deficit. The reserves have thus gradually increased but they are still rather limited, as illustrated by the fact that they correspond to only eleven weeks' imports. Therefore, when bearing in mind the underlying trend of the current account as well as the fluctuations in the supply of long-term foreign finance, the balance of payments would seem to remain a significant constraint on economic policies.

In conclusion, I would like to sum up the reasons underlying the remaining quantitative restrictions on imports to Finland. Firstly, the structural transformation of the Finnish economy towards a pattern which better than the present one corresponds to supply and demand relationships at home and abroad is still going on. While this transformation is in process, the need for imported inputs for development will exert pressure on the balance of payments.

Secondly, I would like to draw attention to Finland's bilateral trade. An important element in its management is that substantial amounts of fuels and raw-materials can be imported to Finland under long-term arrangements. This trade has permitted a greater degree of liberalization of multilateral imports into Finland than would otherwise have been possible for balance-of-payments reasons.

Thirdly, only slight improvement in the current balance is foreseen for 1972 and 1973.

Thus, in the opinion of the Finnish government, these circumstances do not for the time being permit any fundamental changes in the present import system without seriously limiting the possibilities of pursuing a policy of rapid growth and high employment.