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# GENERAL AGREEMENT ON TARIFFS AND TRADE

Committee on Balance-of-Payments Restrictions

## REPORT ON THE CONSULTATION UNDER ARTICLE XII:4(b) WITH FINLAND

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 on 20 June 1972 (see BOP/R/61). In conducting the consultation the Committee had before it a basic document supplied by the Finnish authorities (BOP/132), a Background Paper provided by the International Monetary Fund dated 27 April 1973, and the text of a decision of the Executive Board of the International Monetary Fund taken on 16 May 1973.

2. The Committee generally followed the plan for such consultation recommended by the CONTRACTING PARTIES (see BISD, 18th Supplement, pages 52-53). The consultation was held on 18 June 1973. 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 International Monetary Fund to consult with them in connexion with the consultation with Finland. Upon the invitation of the Committee, the representative of the Fund made a statement as follows:

> "The Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of 16 May 1973, taken at the conclusion of the most recent Article XIV consultation with Finland, particularly to paragraphs 3 and 5 which read as follows:
>
> "3. The deficit on current account of balance of payments, which widened exceptionally, under the influence of various special factors, to SDR 339 million in 1971, narrowed to SDR 145 million in 1972, the equivalent of 1.2 per cent of GDP at market prices. As a result of substantial foreign borrowing, official reserves rose in 1972 by the equivalent of SDR 40 million to SDR 698 million at the end of the year."
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> "5. During the last decade considerable progress has been made in liberalizing trade and payments and the Fund hopes that Finland will persist in its efforts in this regard. Continued progress would also assist in the present stabilization effort."

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 the developments in the Finnish economy and in the balance of payments during the past year. Contrary to the expectations of the Finnish authorities, the deficit on current account in the 1972 balance of payments had decreased by as much as Fmk 800 million compared with the previous year. However, it was expected that there would be a deterioration in the balance-of-payments situation in 1973, and if present trends continued the deficit might be even larger in 1974. The rise in the trade deficit had come in the wake of the present rapid cyclical rise in economic activity and, in order to bring about a tightening of domestic liquidity, the Bank of Finland had very recently introduced a new set of measures. These consisted of a gradual reduction of commercial banks' rediscount quotas, a rise in the discount rate from 7 3/4 to 9 1/4 per cent, partial freezing of medium and long-term capital import proceeds on special accounts with the Bank of Finland, and a cash payments system mainly for the importation of consumer goods including automobiles. These measures were intended to remain in effect until the present period of overheating had passed. The cash payments system, effective from 15 June 1973 covered about one quarter of total imports but was expected to affect the volume of imports only in so far as speculative stockbuilding was concerned.

5. In conclusion, the representative of Finland indicated three basic reasons which, in his opinion, justified the continued maintenance of quantitative restrictions to safeguard the balance of payments. First, the efforts to strengthen the Finnish economy required imported inputs which would exert pressure on the balance of payments. Secondly, Finland's bilateral trade was an important factor in the supply of fuels and raw materials and had permitted a greater degree of liberalization of multilateral imports than would otherwise have been possible; thirdly, the current balance was expected to weaken significantly in 1973 and 1974. Thus, in the opinion of the Finnish Government, no major changes in the present import system could be made for the time being without seriously limiting the possibilities of pursuing a policy of continued rapid growth and high employment.

Balance-of-payments position and prospects and alternative measures to restore equilibrium

6. Some members of the Committee asked for further clarification regarding the present balance-of-payments situation and its future evolution. In particular, further information was requested regarding the current reserves position, and questions were asked regarding the present practice of foreign borrowing and whether Finland would be able to reduce its dependency on this practice in the future. The Finnish delegation was also asked whether it regarded the present deficit level as being an acceptable one. In his reply, the representative of Finland emphasized the clearly worsening trend in the balance-of-payments position. Whereas Finland's official foreign exchange reserves stood at Fmk 2,564 million on 31 December 1972, by 31 May 1973 they had fallen to Fmk 2,190 million. In 1973

the expected deficit would be covered mainly by imports of long and short-term capital, in 1974 these sources would be insufficient and there would be a further decline in foreign exchange reserves. Although it was hoped to gradually reduce the reliance on long-term foreign capital with the increasing diversification of the economy, for the moment the policy was to encourage long-term capital imports.

7. The representative of Finland gave some further explanations regarding the purpose of the measures introduced by the Bank of Finland on 14 June 1973, particularly the two external measures aimed at complementing the present restrictive monetary policy. The partial freezing of medium and long-term capital imports was intended to postpone some of the liquidity effects of these capital inflows until the danger of overheating had passed. The cash payments system was also seen as a monetary rather than a balance-of-payments measure, and was designed to prevent the undesirable liquidity effects of short-term capital inflows. The system covered mainly various types of consumer goods such as foodstuffs, clothing, household durables, and motor vehicles and was identical to the one which was in force from 1970 to 1972. It was not expected that either of the measures concerned would have any significant impact on the volume of imports.

8. In response to questions regarding the probable effects on the balance of payments of recent exchange rate action by the Finnish authorities, the representative of Finland explained that the recent exchange action was taken in pursuit of Finland's present policy to maintain the value of the markka broadly stable in terms of the currencies of her principal trading partners. The IMF representative confirmed that the Fund had noted the exchange rate action and policy of the Finnish authorities.

9. Invited to comment on the possibilities of carrying out further diversification of exports, the representative of Finland emphasized that there had been a constant trend for a reduction in the share of wood-based products in total exports. The latter now comprised some 50 per cent of the total compared with about 75 per cent in 1950.

System and methods of restrictions and effects of the restrictions

10. A number of questions were posed by different members of the Committee aimed at clarifying the situation in regard to the administration of global quotas under the multilateral import treatment. In general, the representative of Finland emphasized that it was important to see the question of global quotas in its proper perspective as about 95 per cent of all multilateral imports were completely liberalized. One member asked the Finnish delegation to explain the apparent discrepancy between the figure for the total annual global quota programme of Fmk 58.5 million referred to in paragraph 6 of the basic document and the figures for actual imports under this heading which were much higher. Another member asked why certain of the specific global quotas had been reduced for 1973. In reply to these questions, the representative of Finland admitted that on the basis of actual import figures some special quotas had been slightly reduced because the quotas had not been fully utilized. However, the figures for the

annual global quota programme were purely indicative and in fact actual imports were always much larger due to the fact that extra foreign exchange was allocated liberally together with the necessary licences for imports under this heading. Thus the indicative figures would in practice have no restrictive effect on imports.

11. Questioned about the reasons for the increase in the percentage share of imports entering under global quotas and individual licences under the multilateral treatment and a relative decline in the share of imports under bilateral treatment, the Finnish representative explained that increasing amounts of items such as oil and sugar were now being imported from multilateral sources. In general he confirmed that bilateral trade was by its very nature much more strictly administered than multilateral trade.

12. One member, commenting on the reduction in imports under bilateral treatment in 1972, asked whether the agreement recently concluded with CMEA might lead to a reversal of this trend. In reply, the representative of Finland pointed out that the agreement constituted principally a framework for the exchange of information, and that it did not replace the trade agreements with individual CMEA members under which bilateral trade was actually implemented.

13. There was some discussion on the question of the import equalization tax. One member of the Committee asked if there had been any changes or modifications to the tax and if there were any definite plans for its removal. The Finnish representative emphasized that the sole purpose of the tax was to prevent domestically-manufactured products from being more heavily taxed than imported goods. Whilst noting that several countries had replaced their equalization tax by value-added tax, he could not state at present when the Finnish equalization tax could be terminated. One member stated that his government regarded the equalization tax as being in contravention of the GATT.

14. In reply to a question concerning administrative procedures for imports of flour, the representative of Finland said that flour had been imported from time to time. He confirmed that import licences were required and that such imports would be carried out by the State Granary.

15. One member returned to two questions which he had raised at the previous consultation. The first referred to the motor vehicle tax which was progressively weighted against the medium-sized and large vehicles and levied on a c.i.f. basis, thus placing his country at a disadvantage. Another member associated his delegation with this concern. The second question related to imports of canned fruit and juices, in regard to which he wished to know whether import licences would still be granted freely. In regard to taxes on automobiles, the representative of Finland stated that there had been no change in the manner of levying the tax, but this tax system was not intended to be discriminatory. On the question of canned fruit and juices, he confirmed that import licences would continue to be granted liberally.

16. One member drew the Committee's attention to the fact that the licence fee imposed by the Finnish authorities was based on the value of the goods imported, and that this was not compatible with Article VIII of the General Agreement which determines that such fees shall be limited in amount to the approximate cost of services rendered. Commenting on this, the Finnish representative noted that licences for large amounts usually had to be extended several times and this involved extra work.

Conclusions

17. The Committee expressed understanding for the nature of Finland's balance-of-payments problems. It was recognized that Finnish restrictions applied only to a narrow range of products, but it was noted that no substantial changes had taken place since the 1972 consultation. The Committee hoped that the Finnish authorities would resume their efforts to liberalize the remaining import restrictions.

## ANNEX

### Opening Statement by the Representative of Finland

At the preceding consultation a year ago I outlined the structural factors conditioning the cyclical vulnerability of the Finnish economy and the special circumstances surrounding the boom and post-boom years of 1970 and 1971. At that time the Finnish authorities anticipated only a slight improvement in the current balance for 1972. Contrary to these expectations, the current deficit decreased by as much as Fmk 800 million from the year before. When due allowance is made for special factors as well as for the relative cyclical position, the recorded current account deficit for 1972 seems to reflect the underlying deficit rather well. In 1973 it is expected that the underlying position of the balance of payments will deteriorate again. In the first five months of this year the trade balance showed a deficit of Fmk 1,043 million, and official foreign reserves declined at the same time by some Fmk 370 million. Just now the Finnish economy is experiencing the current international upswing and enjoys high levels of demand and output as well as falling unemployment. However, the upswing does bring in its wake a considerable rise in the trade deficit.

The unexpectedly fast cyclical upswing actually led the Bank of Finland to introduce a set of measures which were announced last Friday. These consist of a gradual reduction of commercial banks' rediscount quotas, a rise in the discount rate from 7 3/4 per cent to 9 1/4 per cent, partial freezing of medium- and long-term capital imports proceeds on special accounts with the Bank of Finland, and a cash payments system mainly for the importation of consumer goods including automobiles. All these measures are expected to contribute to a tightening of domestic liquidity, and they are intended to be in effect until the period of overheating has passed. The cash payments system, effective from 15 June, will cover about one quarter of total imports but is expected to affect the volume of imports only in so far as speculative stockbuilding is concerned. My delegation is prepared to provide further information on these measures during the discussion to follow. I should now like to continue by surveying recent economic developments.

The slow-down in economic activity which began in Finland late in 1970 was rather mild and comparatively short-lived. The trough was passed early in 1972 and gross domestic product grew by nearly 6 per cent in volume terms, mainly, as a result of a revival in foreign demand. The volume increase in exports of goods and services was 16 per cent, whereas the growth in domestic demand was 2 1/2 per cent only. The most buoyant components of domestic demand were private consumption and general government fixed investment. However, private fixed investment was sluggish in comparison with the previous year. Despite the accelerating growth of output, the employment situation remained comparatively weak, particularly in the northern and eastern parts of the country. In 1972 inflation was about as rapid as it had been in 1971, but in contrast to events in the three preceding years of relative stability, prices rose slightly faster in Finland than in Finland's main Western European trading partners.

During 1972 the rate of growth in the volume of merchandise exports accelerated vigorously. The advance was quite significant even when account is taken of the extensive work stoppages in the metal and engineering industries in 1971. The rapid growth of exports was possible because of a relatively low rate of capacity utilization and because the prices of Finnish exports remained competitive.

In 1972, the volume of merchandise imports grew by only a few per cent. Import prices rose twice as fast as export prices and produced a deterioration in the terms of trade of more than 4 per cent. However, the value of exports increased by 22 per cent and that of imports by only 12 per cent. The trade deficit declined from about Fmk 1,900 million in 1971 to some 1,100 million in 1972. Net service earnings totally offset the trade deficit. The current account deficit of Fmk 600 million, which was down from 1,400 million in the preceding year, thus equalled the net outflow of investment income and transfer payments. As in 1971 there was a material inflow of long-term capital in 1972 giving rise to a substantial basic balance surplus which led to a further accumulation of foreign exchange. The ratio of debt-servicing costs to current receipts remained unchanged at 10 per cent. Economic policy was not explicitly constrained by the external account and emphasis could thus be placed on problems of internal stability.

In the first half of 1973 the Finnish economy has been running at a high level of activity; the rate of capacity utilization has risen and unemployment has declined steadily. For the year as a whole, gross domestic product is expected to increase by 6 1/2 per cent in volume terms. Next year growth should continue at almost the same rate.

The rise in costs and prices is expected to accelerate slightly in 1973 and will probably be substantial in 1974. A considerable part of the increase will be due to higher import and export prices. Economic policies will again be increasingly directed at improving overall stability in the face of a growing imbalance between supply and demand. The sharp rise in the share of imports in the total supply of goods and services is the clearest sign that disequilibrium is approaching quickly. In January-May the value of imports expanded by 29 per cent from the corresponding period last year compared to only 21 per cent for the value of exports. According to present projections the current account deficit will be three times as large in 1973 as it was last year. In other words the deficit would, as in 1971, amount to 3 per cent of gross domestic product. If present trends continue the deficit may be even larger in 1974.

Continuing uncertainty in the world monetary climate has greatly affected the prospects for long-term capital imports. Even without this factor, long-term capital markets are subject to large and often sudden variations, and it is thus obvious that balance-of-payments policies cannot be made on the assumption that capital can be imported readily. Furthermore, the exchange reserves have begun to shrink and now correspond to less than two months' imports. Therefore, in light of the deterioration on current account and the uncertainty about the supply of long-term foreign capital, it seems likely that balance-of-payments considerations will soon reduce the scope of manoeuvre for general economic policy.

In conclusion I should like to indicate three basic reasons why quantitative restrictions to safeguard the balance of payments are still needed. First, the on-going efforts to transform the Finnish economy so that it will be able to meet the exigencies of supply and demand at home and abroad require imported i uts which exert pressure on the balance of payments.

Secondly, Finland's bilateral trade is an important factor in the supply of fuels and raw materials. This trade has permitted a greater degree of liberalization of multilateral imports than would otherwise have been possible.

Thirdly, the current balance is forecast to weaken significantly in 1973 and 1974. Indeed, in the first quarter of this year, the current account deficit amounted to about Fmk 520 million which on an annual basis is between three and four times the deficit recorded last year.

Thus, in the opinion of the Finnish Government, no major changes in the present import system can be made for the time being without seriously limiting the possibilities of pursuing a policy of continued rapid growth and high employment.