

GENERAL AGREEMENT ON
TARIFFS AND TRADE

RESTRICTED

BOF/R/95
3 June 1977

Limited Distribution

Committee on Balance-of-Payments
Restrictions

REPORT OF 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 29 April 1976 (see BOP/R/87). In conducting the consultation the Committee had before it a basic document supplied by the Finnish authorities (BOP/172) and a background paper provided by the International Monetary Fund dated 19 April 1977.
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 24 May 1977. 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:

"In each of the past two years, the growth of real GDP in Finland was limited to about one half of 1 per cent. In 1975, strong domestic demand offset an unprecedented fall in the volume of exports, but contributed to a high rate of inflation and a current account deficit equivalent to over 8 per cent of GDP. On the other hand, export markets partially recovered in 1976 while total domestic demand fell by about 4 per cent in response to a restrictive shift in fiscal policy and an extremely tight monetary and foreign borrowing policy. The volume of fixed investment demand was sharply reduced, declining by 13.5 per cent, and unemployment rose to 4 per cent of the labor force on average. Despite reduced domestic demand and the imposition of a five-month price freeze, the rate of inflation remained higher than in most other industrial countries. Wage earnings, unit labor costs, and consumer prices rose on average by about 14.5 per cent, but corporate profitability declined for the second successive year, particularly in the metal and engineering industries.

An incomes agreement for 1977-78 is presently being negotiated at the individual union level. Although there is still some industrial unrest, most of the important unions have agreed to proposals suggested by the official conciliator which, if fully accepted, are estimated by the authorities to result in a growth of wage earnings of 8 per cent and an increase in unit labor costs of around 7 per cent in 1977. In conjunction with the depreciation of the markka in April 1977, these developments would move Finnish costs more into line with those of competitor countries. As the deceleration in the rate of price increase is expected to be smaller than the reduction in the rate of increase in earnings, a fall in real wages and a recovery of corporate profitability should occur. Restrictive fiscal and monetary policies are expected to be maintained throughout 1977 and a further fall in fixed investment demand is forecast. Aided by continued recovery in export markets, real GDP in 1977 may increase more strongly than in 1976, but by an amount insufficient to allow a reduction in the average rate of unemployment.

The adjustment of Finland's balance of payments position in 1976 was notable as, despite a 3 per cent deterioration in the terms of trade and a deterioration in the balance of services caused mainly by higher debt servicing costs, the deficit on current account was almost halved from SDR 1.8 billion in 1975 to SDR 1.0 billion, the equivalent of less than 4 per cent of GDP. Economic recovery in Finland's markets in Western Europe enabled the volume of merchandise exports to increase by one fifth, while import volume declined by 2 per cent reflecting depressed domestic demand conditions and a rundown of stocks of imported goods. In the first quarter of 1977, a surplus was recorded on the balance of trade for the first time in over three years. This would appear to indicate a continuing growth of exports and the likelihood of a further substantial reduction in the deficit on current account for the year as a whole. On April 5, 1977, in order to mitigate the repercussions of exchange rate action of Finland's Scandinavian trading partners, the external value of the markka was depreciated by 5.7 per cent against the Bank of Finland's trade-weighted basket of currencies.

The net inflow of long-term capital was reduced in 1976, in part reflecting stricter surveillance of foreign borrowing by the Bank of Finland. Nevertheless, the current account deficit was almost completely covered by net long-term capital inflow of SDR 0.9 billion. In 1975, gross official convertible reserves declined sharply to SDR 401 million at the end of the year, and little improvement in the reserve position has since taken place. In 1976 reserves increased by SDR 28 million, entirely owing to an Oil Facility drawing of SDR 115 million, and at the end of March 1977 gross

official convertible reserves amounted to SDR 413 million, equal to the cost of only about three and one half weeks of imports. The equivalent of SDR 132 million was also held under bilateral payments arrangements. Finland has unused stand-by credits with foreign commercial banks amounting to US\$690 million.

The import deposit scheme, originally intended to remain in effect for one year from March 1975 was extended in March 1976. Its incidence was reduced gradually according to an announced schedule until its full abolition on December 31, 1976. Finland maintains global quotas and individual licensing in respect of certain agricultural products, mineral fuels, and unwrought gold and silver when imported from the market economies. These restrictions are maintained both for balance of payments and other reasons (e.g., for reasons of domestic agricultural policy).

There has been a significant improvement in Finland's balance of payments position on current account in 1976 and further progress is expected in 1977 toward the authorities' goal of reducing the underlying current account deficit to not more than 2 per cent of GDP by 1980. However, it is not expected that there will be any substantial improvement in the reserve position in 1977. Thus, the Fund believes, in view of the extremely low level of Finland's external reserves, that the present system of import quotas and licensing is, for the present, not unwarranted.

Opening statement by the representative of Finland

4. In his opening statement, the full text of which is contained in the Annex, the representative of Finland described the balance-of-payments position of Finland and pointed out that although the deficit on current account had diminished, the situation remained serious. He went on to describe the effects of the recent cyclical downturn which had been felt in Finland only in 1976, when economic activity in the OECD area was expanding again. He also described the situation of fixed investment during 1976, and brought out the salient points of present and future economic policy, in particular with regard to labour, wages and fiscal policy, the effects of the recent devaluation of the Finnish markka, and the situation of employment. In conclusion, he said that the Finnish Government felt a decisive reduction in the growth of foreign indebtedness was necessary to ensure stable and sustained economic expansion in the future. Against this background the outlook for Finland's current account balance was not very good. In the face of adverse external conditions the improvements achieved and expected in the near future, involved heavy costs in the form of under-utilization of resources. Therefore, it was his Government's opinion that circumstances did not for the time being permit changes in the present import system.

PARTS I and II

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

5. Members of the Committee thanked the representative of Finland and the representative of the International Monetary Fund for the very complete information they had supplied to the Committee. The timely notification by Finland of the changes in its import restrictions was particularly appreciated. The Committee welcomed the termination, as announced at the last consultation, on 31 December 1976 of the import deposit scheme. It noted from the documentation before it that although the Finnish reserves were very low and the balance-of-payments situation serious, there had been some improvement since the previous consultation in April 1976; it was noted in particular that the deficit on current account had been reduced. It was recognized that the overall balance-of-payments situation remained difficult and that some restrictions were warranted.

6. It was recognized that the single most serious element in Finland's balance-of-payments situation was the very low level of its reserves in convertible currencies which were understood to stand at some three weeks of imports. In this context it was asked whether this situation was expected to continue and if so whether it could trigger the introduction of new import restrictions in 1977. It was also asked what forecasts had been made by the Finnish authorities for balance-of-payments developments in 1977 and 1978. The representatives of Finland said that the objective of the Finnish authorities was to reduce the deficit on current account to a figure not greater than 2½ per cent of gross domestic product by 1980. He added that a better performance of the economy would be needed to reach this goal. With regard to forecasts the representative of Finland recalled that in 1975 there had been a balance-of-payments deficit of some Fmk 8.0 billion; in 1976 Fmk 4.0 billion, 1977 a deficit of Fmk 2.0 billion was expected and it was believed that by 1978 that figure could be lower due to an increase in exports.

7. Members of the Committee noted that in April 1977 the Finnish markka had been depreciated by 5.7 per cent against a trade-weighted basket of currencies, following the devaluations of Finland's Scandinavian neighbours. As the representative of the International Monetary Fund had pointed out, the depreciation of the markka had been somewhat larger than that of other Scandinavian currencies; it was asked what the effects of this depreciation were expected to be. The representative of Finland pointed out that the depreciation of the markka had been of the same order as that of the Swedish Kronor and recalled that Sweden was Finland's largest competitor and market. The effect on the export performance would therefore be only to restore Finland's competitive position on the Swedish market and the markets of third countries. The effects on prices and costs would

be of the same order as the depreciation, i.e. 5 to 6 per cent and that these increases in prices and cost had been taken into account in the various estimates and forecasts. In reply to questions concerning estimated imports and exports the representative of Finland said that fairly accurate figures existed for 1977 whereas for 1978 the figures were more nebulous. An increase of 11.5 per cent in the volume of merchandise exports was forecast for 1977 and half as much for 1978. Merchandise imports were expected to grow by 1 per cent in 1977 and by slightly more in 1978.

8. Members of the Committee noted that the rate of inflation in Finland had been consistently higher than the rate of inflation in other industrial countries and asked what anti-inflationary measures had been taken. The representative of Finland recalled the measures he had described in his opening statement, and in the basic document for the consultation, on price control and wage agreements. He added that in general the outlook was not positive with regard to inflation. An increase in prices of 10 per cent was expected for 1977 and a further increase of some 7 to 8 per cent in 1978, which was higher than the average of OECD countries.

9. Members of the Committee commented on the strict control the Finnish authorities had applied on the level of foreign borrowing. With regard to the ceiling of Fmk 4 billion set for foreign borrowing for 1977 it was asked whether this included only short-term or both short and long-term capital borrowing, and how much of the quota had already been utilized. The representative of Finland said that the level of foreign borrowing was an essential concern to the Finnish authorities who felt that the country's foreign indebtedness should be reduced, in particular its short-term indebtedness. It was in this context that the Cash Payments Scheme for certain imports had been enlarged. There were no breakdowns available at this time as to how capital imports were distributed in 1977 between short and long-term borrowing. The Government endeavoured to discourage any increase in short-term borrowing. Questions were also asked on the strict monetary measures and the guidelines that had been given to banks regarding the type of loans that they should give priority to. In this context it was asked what was the practical effect of the requirement that banks discriminate against loans to finance inventories of imported goods and whether the requirement to discriminate against loans for consumer durables applied equally to domestically produced consumer goods as well as imports. The representative of Finland replied that the termination of the Import Deposit Scheme had brought about an increase in the money supply which was neutralized by tightening Central Bank quotas. The Bank of Finland had requested private banks to limit themselves in the financing of, for example, unwarranted inventory replenishments in order to safeguard the general economic policy aimed at stable growth and balanced external accounts for Finland. The main concern was to stimulate productive investments and ensure their financing and therefore to limit loans for less productive investments.

10. It was asked whether the Finnish authorities had plans for further drawings on the IMF's facilities. The representative of Finland said that no decision had been taken in this regard so far. In reply to questions asked concerning energy conservation measures the representative of Finland said that measures had been taken in this field since 1974 and that good results had been obtained in particular in the heating of buildings but also in some industrial sectors. It was expected that the supply of energy would exceed the demand for energy over the next few years and that the rate of growth of demand for energy in the ten years to come would be lower than that of the growth rate of the gross domestic product.

11. In reply to questions concerning measures aimed at the diversification of exports the representative of Finland recalled that a higher degree of diversification had been achieved after the war and especially through the sixties and seventies. Besides its traditional forestry production Finland had developed to a considerable degree its metal and engineering industries, exports of which had more than doubled between 1969 and 1977; also the chemical, clothing and other consumer products' industries had seen considerable expansion.

12. Members of the Committee noted that the level of unemployment had risen steadily over the past few years; 2 per cent in 1975, 4 per cent in 1976 and nearly 5 per cent (4.8) in 1977. It was asked whether Finland envisaged taking measures to stop the deterioration in the unemployment situation. The representative of Finland said that this was one of the priorities in the programme by the recently formed Government. It was too early at this stage to have an idea of what concrete measures could be expected.

13. Members of the Committee noted that Finland for many years had had one of the highest rates of investment of industrial countries and asked whether this had favoured development of production for import substitution or for export. The representative of Finland confirmed that his country had one of the highest investment rates, gross fixed investment on average in excess of a quarter of gross domestic product. However, this had not been matched by a commensurate growth rate. He explained that Finland was a recently industrialized country and that a vast amount of investment had been needed for the country's infrastructure: such as the building of roads, dwellings, hospitals etc. In the future such structural investments would not be needed to such a great extent, and the Government had also endeavoured to favour productive investments.

PARTS III and IV

System, methods and effects of the restrictions

14. A number of questions were asked concerning the Cash Payments Scheme described in the basic document BOF/172. This Cash Payment Scheme originally introduced in 1973 subjected some 15 per cent of imports to a requirement of full cash payment before customs clearance. The Scheme had been enlarged on 1 March 1977 to more products, including certain raw materials and production equipment and now covered one third of all imports. It was not clear to the Committee whether this measure was intended to reduce the level of internal demand for these products or whether it was intended to reduce the level of foreign indebtedness. The representative of Finland stated that the principal objective of the Scheme was to bring about a change in the share of short-term foreign borrowing in order to make it possible to have a corresponding increase in longer-term capital imports. He assured the Committee that the measure was not a balance-of-payments measure to restrict imports but was a monetary measure which would have no effect on the total level of imports. Members of the Committee felt however that despite the monetary character of the Cash Payments Scheme the measure was likely to affect the imports of the products listed. In this context they asked on what criteria the products had been chosen. The representative of Finland said that the list contained mainly consumer goods but that it had been enlarged to cover certain raw materials and semi-processed goods. He pointed out that the stringent monetary policy had made it increasingly difficult for domestic producers to deliver their products on credit and that the enlargement of the coverage had been introduced to extend the monetary stringency to foreign goods as well. He added that the Scheme, like all such schemes, was flexible to some extent and that it was not his authorities' intention to cause undue hardship to producers and importers. Some members of the Committee asked whether the measure, taken in support of monetary policy, would be discontinued should the reduction in the balance-of-payments deficit continue to develop favourably. They also asked whether importers of goods subject to the cash requirements scheme could obtain financing on credit terms similar to those available to domestic producers of the same goods; and whether the cash requirement applied to imports regardless of origin. The representative of Finland reiterated that the measure was one of monetary policy and not for balance-of-payments reasons. It applied to imports from all sources regardless of country of origin. Credit terms from Finnish banks were the same as those given to domestic producers. Commenting on the enlargement of the measure to cover certain raw materials one member of the Committee remarked that this might affect certain export industries in Finland.

15. The Committee welcomed the termination on 31 December 1976 of the Import Deposit Scheme. It was asked whether the Finnish authorities considered that the import deposits had been an important factor in reducing the growth of imports during its existence. The representative of Finland replied that no specific calculations on the effects of the scheme on aggregate imports had been made as the scheme had been designed to operate through the financial market. The financial burden was limited to the interest foregone on the deposits. This had different effects on importers according to the firms' level of liquidity. Experience had shown that in certain cases the exporter had helped finance the deposit, although this had not been the intention of the Bank of Finland. Without basing it on precise calculation it was generally thought that the import deposit had had a marginal effect on restraining demand through the financial channels and may have had a marginal effect of reducing imports.

16. Members of the Committee noted that Finland still maintained global quotas on some 1 per cent of total imports and individual licensing on some 9 per cent of imports. It was asked to what extent this licensing was maintained for balance-of-payments reasons or other reasons and whether it could be expected that they would be phased out with an improvement in the balance-of-payments situation. It was also noted that since 1973 Finland had practised surveillance licensing on certain products and it was asked whether this would continue in 1977. A further question was asked concerning the procedure for granting licences; this was based on the level of the previous year's imports for individual firms and it was asked whether any provision was made for new importers to obtain import licences. The representative of Finland said that the justification for Finland's licensing system was to be found both in balance-of-payments reasons and in other policy reasons. Article XII:4(b) seemed, however, to be the best justification for the restrictions as it covered all products in question. He recalled that by far the largest group of products under licensing consisted of fuels and oil and that this item affected the balance of payments in a direct way. With regard to the quantitative restrictions on certain agricultural products it was clear that these products had been chosen because they could be domestically produced. He recalled that the number of products under licensing was very limited and it was hoped that the number would be further reduced as the balance of payments would improve. Concerning the allocation of quotas and licensing the guidelines were based on past performance in terms of price, volume and quality. However, there was some 5 to 10 per cent of licences reserved for new importers. As regards the surveillance licensing for certain durable products he pointed out that these amounted to less than 2 per cent of imports under licences and that under the present circumstances it was still considered necessary to follow the developments of the market for these products very closely and therefore no change could be expected in the short run.

17. It was pointed out that since September 1976 importers who were at the same time wholesalers were required to pay the turnover tax at the time of clearance of the goods at customs rather than at the moment of sale. It was asked why this measure had been taken and whether it was expected to continue. The representative of Finland explained that the turnover tax introduced in 1976 was part of a major fiscal reform and that for technical reasons changes had been introduced in the points of tax collection. It had been decided that during a first stage the turnover tax would be collected at importation and equivalent timing for collection was expected to be applied to internal trade as soon as possible, in any case not later than the end of 1978. His authorities had the matter under constant review. He added that the tax burden had not been increased with the change and that it was the intention of his authorities to implement the changes in a non-discriminatory way.

Conclusions

1. The Committee welcomed the termination on schedule of the Import Deposit Scheme and appreciated Finland's observance of GATT notification and consultation obligations.
2. Taking into account the Fund's view that despite the improvements in Finland's balance of payments on current account, no improvement could be expected in 1977 in the low level of Finland's external reserves, the Committee recognized that there was need for a degree of trade restriction. The Committee noted that some Finnish restrictions - global quotas and licensing - were imposed for balance-of-payments and other reasons, and welcomed the Finnish authorities' intention to consider further limitation of the level of trade restrictions in case the balance-of-payments situation would permit such relaxation.
3. The Committee expressed some concern as to the possible trade effects of the Cash Payments Scheme, as enlarged in April 1977. Although it noted that the Scheme was introduced primarily as a monetary measure, it felt that any detrimental effects on trade should be avoided.