

# GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

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

### F I N L A N D

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/23), together with an annexed Finnish booklet entitled "Importation System in Finland - State as of January 1, 1963", and a document supplied by the International Monetary Fund as mentioned in paragraph 3 below.
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 12 June 1963. The present 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 this consultation with Finland. In accordance with the agreed procedures, the representative of the Fund was invited to make a statement supplementing the Fund's document concerning the position of Finland. The statement made at the consultation by the representative of the Fund was as follows:

"The International Monetary Fund has transmitted to the CONTRACTING PARTIES a background paper, dated May 29, 1963, to supply background information on recent developments.

"With respect to Part I of the Plan for Consultations, relating to balance of payments position and prospects, and with respect to Part III, relating to system and methods of the restrictions, the Fund expects to conclude in the near future a consultation with Finland under Article XIV of the Fund Agreement and to transmit to the CONTRACTING PARTIES the Executive Board decision relating to that consultation when it becomes available.

"With respect to Part II of the Plan for Consultations, relating to alternative measures to restore equilibrium, pending the conclusions of its next consultation with Finland, the Fund has no comments on alternative measures."

Opening statement by the Finnish representative

4. In his opening statement, the full text of which is annexed to this report, the representative of Finland described the principal developments in the Finnish economy and in the import control and restriction system since the last consultation with Finland in October 1962. It was noted that since last October the growth of the Finnish economy, which had been at a fairly satisfactory rate in recent years, had slowed down and had now stopped. The end of the boom had been somewhat more abrupt in Finland than in more industrialized countries and the slowing down of external demand for forestry products had created serious repercussions on the Finnish economy. The expansion of the Finnish wood-working industry, though wholly justifiable and desirable from the long-term point of view, had brought about an excess capacity for the time being. The recession in Finland, it was hoped, would soon be over but the beginning of recovery largely depended on the development of export income. Total Finnish production in 1963 was expected to record only a 1 or 2 per cent increase in volume from the 1962 level, and even this was due largely to the anticipated better harvests.
  
5. Private industrial investment activity showed a downward trend which had not been fully compensated by the increase in public investment. Private and public consumption were the main factors which maintained the level of activity. Labour's share in the national income had been increasing in recent years and this, coupled with the psychological effects of certain inflationary anticipations among the public, had supported a consumption boom of impressive magnitude. While the rise in real income was slowing down, consumption expenditure still showed a tendency to increase, partly at the expense of savings. For the current year, it was estimated that the volume of consumption would increase by approximately 2 per cent which was less than the increase for 1962. Consumption expenditure, which remained particularly high in the durable goods sector, continued to be a disturbing factor in the monetary and balance-of-payments situation of the country. The monetary situation in Finland had been marked by continued stringency of the money market and had been aggravated by fiscal developments. In the inflationary atmosphere the growth of savings by the public had not been satisfactory. Consequently, the banking system had consistently been in debt to the Central Bank. Various strict control measures taken by the Bank of Finland had stopped the expansion of bank credit and the private banks had been able to reduce their indebtedness to the Central Bank.
  
6. The budgetary position was particularly difficult this year as the recession in the economy called for large outlays for public works at the same time as the growth of revenue slackened. The financing of the expected cash deficit, therefore, required increases in indirect taxes on certain other measures such as compulsory borrowing from the public.

7. Against this background the balance-of-payments position remained weak. The rapid expansion of the economy in 1960/62 had resulted in increasing deficits which helped to absorb excess demand at home and thereby relieved pressure on prices. Due to the present recession, the balance-of-payments position was improving although remaining in deficit. Although import demand was falling, particularly for investment goods, exports were no longer expanding and even on most favourable assumptions the aggregate export income was not expected to exceed the 1962 level. The current account deficit was expected to be of the order of Fmk.100 million. Though possibilities for long-term borrowing might have been improved recently, it was unlikely that such borrowings would be sufficient to provide large-scale support to the balance of payments. On the other hand, the Bank of Finland had introduced certain restrictions on short-term borrowing; hence the balance-of-payments deficit in the current year would bear more directly than before on the foreign exchange reserves.

8. Referring to the restrictive system, the representative of Finland stated that his Government was anxious to avoid the introduction of new quantitative import restrictions. In spite of the difficult situation, the scope of the licence-free import system had been further extended and 340 tariff items and sub-items had been liberalized on 14 December 1962. On 1 January 1963, Algeria, Burundi, Jamaica, Ruanda, Syria, Trinidad and Tobago, Uganda, Western Samoa and Yugoslavia had been added to the list of countries enjoying "multilateral import treatment". The amount of global quotas applicable for 1963 had been increased on 10 June 1963 and now amounted to Fmk.402 million which represented an increase of more than 10 per cent in the quotas compared with 1962. In conclusion, the Finnish representative said that it would be the policy of his Government to remove the remaining import restrictions as far as permitted by the balance-of-payments position.

#### Balance-of-payments position and prospects

9. The Committee thanked the representative of Finland for his clear and comprehensive description of the main developments in the Finnish economy and the import control system. The Committee then discussed with the Finnish representative different aspects of his country's balance of payments. In reply to questions concerning the diversification of economy, the representative of Finland stated that the exploration of new lines of production was one of the principal concerns of his Government. At present the wood-working industry still accounted for two thirds of Finland's export trade. Diversification had become imperative partly because a stage had been reached where timber cutting had exceeded the natural growth of timber resources. This sets, at least in the short run, a limit on the expansion of export earnings from timber, pulp and paper, which had traditionally been important items in the Finnish export trade and in which industries, particularly regarding pulp and paper, a strong expansion of productive capacity had taken place in recent years. While there existed a ready market and good long-term prospects for most of these products, actual export earnings depended to a very large extent on the general level of economic activity abroad.

In order to diversify the economy and to provide a broader base for exports, Finland had encouraged investments in the metal and engineering industries, such as of paper making machinery, with satisfactory results. Investment in these industries had also been stimulated by the need to improve, through increased efficiency, the competitive position of Finnish industry in view of the movement towards regional economic integration in Europe.

10. In reply to a question the Finnish representative stated that the exceptionally high figure for the exports of metal and engineering products in 1962 was due to the postponement of deliveries of ships from 1961 apart from increases in other manufactured exports to western countries.

11. In discussing the prospects for the inflow of long-term foreign capital, the representative of Finland stated that an increase in the inflow of such capital would make a significant contribution towards an easing of the pressure on the country's foreign exchange reserves, but due to its peripheral position, such credits were not always available to the desired extent or on terms equal to those offered to other European countries. The policy of the Government was to attempt to obtain such loans wherever possible on reasonable terms. Thus, increasing reliance on international capital markets might develop as compared to the inter-governmental and quasi-official institutions which so far had provided the bulk of Finland's long-term capital imports. It was encouraging that for the first time since the war Finland had been able to float bond issues in the private capital markets of Switzerland (30 million Swiss francs) and the United States (US\$12.5 million), but these amounts were very small in comparison with the aggregate balance-of-payments deficits of recent years. Only the previous week, a new loan of DM25 million had been granted to Finland by the Reconstruction Loan Corporation in Frankfurt, and possibilities of further borrowing on the private capital market in the Federal Republic of Germany were being explored. Within Finland, a development finance institution was being organized to assist in the financing of small and medium-size industry, and it was hoped that equity participation by the International Finance Corporation and private banking firms in Western Europe and in the United States, as well as a loan from the IBRD could be obtained for this purpose.

12. In answer to questions concerning the implications of short-term capital movements for the reserve position of Finland and the prospects for the country's foreign reserves in 1963, the representative of Finland stated that it was true that an increase in short-term borrowings from abroad had been registered in 1962 but certain restrictions had been imposed on the inflow of such credits towards the end of that year because it was felt that short-term borrowing abroad had been expanding too much. Such credits, which might fluctuate sharply, were also counteracting to some extent the restrictive credit policy of the Central Bank. It was extremely difficult to estimate the developments in foreign reserves in 1963 because of the lack of definite information regarding the availability of long-term loans and owing to the shifts in short-term capital flows, including leads and lags in Finnish export and import payments. The 1963 payments deficit should be smaller than in the preceding year. The Finnish Government was anxious to seek to redress the current deficit in the balance of payments without the use of additional quantitative restrictions.

Alternative measures to restore equilibrium

13. Members of the Committee enquired whether, in the view of the Finnish authorities, the present slow rise in real income, the disappearance of excessive demand for labour and the reduced deficit in the balance of payments indicated a lasting improvement in the stability of the economy. The representative of Finland replied that, while unemployment this year was expected to reach 2 per cent, his Government had the legal obligation to provide employment and for this purpose construction programmes were timed so as to absorb unemployed labour. Although the boom was over, there were other factors maintaining demand at a high level. Wages had been increased as a consequence of strikes while productivity was not rising as much as before. The Government had taken budgetary measures and was contemplating a stabilization programme. No serious problems of inflation were expected if these measures proved successful. However, demand pressure remained, even though it had become a problem of much diminished dimensions.

14. In response to a question concerning the effectiveness of the measure adopted by Finland in October 1962 of requiring cash payments before customs clearance for certain imports, the representative of Finland stated that the measure formed part of the overall credit restriction policy of the monetary authorities and was in fact related to the desire to restrict short-term overseas borrowing to finance imports. The arsenal of monetary policy was rather limited - there was, for instance, no legal authority for the Central Bank to vary reserve requirements. The Bank of Finland had imposed restrictions on commercial banks' borrowing abroad, and supplemented these with restrictions on the use of import credit. The requirement for cash payments had had some effect on imports although these were not yet reflected in trade statistics. This was partly due to the fact that provision was made in the regulations to exempt from the requirement imports for which firm orders had been placed before the regulations came into force. A member of the Committee asked whether the requirement applied only to consumer durable goods and whether the system operated in a way which would discriminate against distant suppliers. The Finnish representative replied that the requirement applied only to certain consumer durable goods. Payments to the foreign exporter had to be effected before imports could be cleared through the customs. The system did not in any way discriminate against distant suppliers.

15. Members of the Committee showed considerable interest in the legislation passed in August 1962 establishing price regulation and governmental subsidies for farm production and variable levies on agricultural imports. In view of the fact that food prices had risen sharply in 1962 and had to be subjected to price controls, the Finnish delegation was asked whether a policy of moving towards more access for food imports from lower cost producers would assist in halting the pressure on domestic food prices. The representative of Finland explained that the Act opened a new phase in Finnish agricultural policy by enabling the Government to discourage excess production. Under this law, import duties were replaced by fixed and variable import levies. Most of the agricultural products were subject to fixed import levies while on some items variable import levies were collected. Items bound under the General Agreement were only subject to fixed levies which of course in no case exceeded the bound rates. The receipts from the levies were to be transferred to a Marketing Fund and utilized for compensating farmers, export subsidies for agricultural products and other purposes.

16. A member of the Committee asked about the restrictive effects of last year's monetary measures on credit expansion and consumer demand, and about any monetary or fiscal measures contemplated for 1963. The representative of Finland stated that his Government preferred to rely on monetary and fiscal measures rather than on quantitative restrictions. The application of fiscal measures was, however, difficult in a country like Finland where government expenditure was largely determined by legislation, leaving little room for manoeuvre. In view of the slow rise in revenue, efforts had been made to keep down budgetary expenditure as much as possible. As regards monetary policy, the application of progressively increasing penalty interest rates had been effective in containing credit expansion. His Government was planning to improve the various tools of counter-cyclical monetary and fiscal policy, but this would have effect only in the longer run and it was too early to give specific information on these measures.

17. The representative of Finland, in answering a question concerning the price control measures taken in September and November 1962, explained that these measures had been taken in anticipation of the currency reform. The list of commodities affected was fairly extensive. The measure had been fairly effective in restraining price rises. The removal of this measure was being considered by his Government.

#### System and methods of restriction

18. The Committee welcomed the new liberalization measures taken by the Finnish Government in December 1962, and the increase effected in global quotas on 1 January and supplemented on 10 June 1963.

19. In response to questions relating to the operation of bilateral payments agreements with Colombia, Greece and Turkey, the representative of Finland explained that these were the only remaining countries outside Eastern Europe with which his country had bilateral payments agreements. The bilateral agreement with Colombia related only to the importation of coffee, which was paid through the clearing account; all other Finnish imports from Colombia were settled in convertible currencies. Finland was continuously in deficit under this agreement. Individual licences were required for all imports into Finland from Greece and Turkey, and at certain intervals half of the clearing balance was settled in convertible currencies. The Government of Finland was prepared to terminate any of these agreements if and when this was consented to by the partner government, and if a reasonable method of settling the outstanding balances could be agreed upon. In clarification of the statement in the "basic document" that "trade between Israel and Finland is bound by indicative commodity lists, but payments are settled in convertible currencies", the representative of Finland stated that imports from Israel was not limited to the indicative lists.

20. A member of the Committee noted the statement made by the Finnish authorities that the general policy of Finland was to reduce to the minimum possible the number of goods subject to discretionary licensing and to include them in global quotas or in the free importation system. He enquired what further action had been taken by Finland in this direction. The representative of Finland stated that since the last consultation some items had been transferred from the discretionary licensing to the free importation system. Details of these changes were described in the background documents. In reply to another question the representative of Finland also assured the Committee that in the reorganization of the global quota system there had been no intention to increase the restrictions on imports of any item; the increase in the number of quotas had been a purely technical measure.

21. A member of the Committee recalled that it had been stated during the last consultation that Finland was considering acceding to the International Wheat Agreement and enquired if Finland had joined the Agreement. The representative of Finland answered in the affirmative.

22. A member of the Committee noted that the tax on automobiles introduced at the time of the administrative liberalization of this product was considered to be of a temporary nature and that a reduction in its rates had been contemplated for 1 January 1964. He enquired whether the reduction, with a view to the ultimate abolition of the tax, was still being planned by the Finnish Government. The representative of Finland replied that the rising importation of automobiles had posed a serious problem when viewed in relation to the adverse balance-of-payments position of the country. There had been an increase in imports of over 40 per cent in unit terms in the year ending 30 April 1963. In 1961-62, 18,000 cars were imported while in 1962-63 the figure reached 26,000 units. Furthermore the slow down in the rise of budgetary receipts was a matter of concern. The tax, which was not levied on automobiles imported for use as taxis had to be maintained for the time being, and no decision had yet been taken as to the rate of tax to be applied in 1964.

#### Effects of the restriction

23. The Committee welcomed the statement by the Finnish representative that it was the general policy of the Finnish Government to proceed, as far as the balance-of-payment position permitted, with the removal of import restrictions and that with regard to imports still subject to discretionary licensing, the authorities would continue to avoid undue protection and discrimination.

#### General

24. The Committee expressed appreciation of the detailed information provided by the Finnish delegation and of the frank and full answers given throughout the consultation. The Committee welcomed the steps taken by Finland since the last consultation in removing restrictions, increasing global quotas and reducing discrimination in the face of considerable economic setbacks. They hoped that Finland would continue to relax restrictions as rapidly as the balance of payments would permit and would make further progress in the removal of discrimination, including that arising from bilateralism.

ANNEX

Opening Statement by the  
Representative of Finland

It was only some eight months ago that this Committee concluded the previous consultations with Finland. Thus, we have a relatively shorter period of developments to review this time. Nevertheless, enough has happened since last October to provide us with a number of topics for discussion.

In the months which have elapsed since the last consultation, certain further liberalization measures have been taken by my Government. The details are set forth in the basic document which has been submitted to the Committee, and in the background paper prepared by the International Monetary Fund. Before we come to the details of the restrictive system applied in Finland, I should like, however, to describe briefly the general economic developments against which our restrictions ought to be considered.

During the last consultations, it was already evident that the boom conditions which had prevailed in Finland during several years were showing obvious signs of slowing down. Since last October, this development has been going on. The rate of growth of the Finnish economy, which was quite satisfactory in recent years, has not only diminished but entirely stopped. In 1961, the gross national product rose by as much as 7 per cent; in 1962 by only 3 per cent; at the present moment the growth rate is zero. We are thus experiencing a period of recession which, we hope, will be relatively short. Nevertheless, this change in the business cycle developments has brought with it a number of problems which are causing considerable concern to the authorities.

The slowing down of the boom is not peculiar to Finland only; various western European countries are experiencing the same development. However, in Finland the end of the boom was somewhat more abrupt than in more industrialized countries in western Europe. Finland is, after all, to a considerable extent a producer of primary products; our export trade, which accounts for nearly one quarter of the national income, consists largely of raw materials and semi-finished products which enter the production process of the receiving countries. The present slackness of demand for forest industry products in our main markets has had serious repercussions in the Finnish economy.

You will remember from previous discussions in this Committee that the Finnish woodworking industry, which account for about two thirds of our export trade, entered into a phase of strong expansion in the late 1950's. That period of expansion is by and large over now although a relatively high rate of investment in the industry continues. The expansion programme has proved fully justified as far as the long-term prospects of the industry are concerned, and, in the long run, without it Finland would have lost some of its share of the world market. In the short run, however, there is today some excess

capacity in the industry, and already during much of 1962 the paper and pulp mills were running at a rate which was well below the theoretical capacity. It seems that the bottom of the recession will be passed during the current year, but the beginning of a recovery will depend essentially on the development of export income which at the present moment is difficult to forecast.

I mentioned before that the growth rate of the Finnish economy is zero at the present time. It is estimated that the total production in 1963 will grow only one or two per cent in volume from the 1962 level, and a considerable part of even this modest growth results from the fact that last year the harvest was very bad whereas prospects for the current year are much better. There is an actual fall in the production of the timber industry while other industries including building will produce a volume roughly equal to that of last year. No large scale unemployment is expected partly due to an increase in public works. Even so, in the current year, the number of unemployed is estimated to average some 2 per cent of the labour force compared with 1.2 per cent in 1962.

Private industrial investment activity has been slowing down in the present phase of the business cycle to an extent that has not been compensated by increasing public investments. As a result, private and public consumption are the main factors which maintain the level of activity in Finland at present. As is normal in boom conditions, the share of labour income in the national income has been increasing in recent years, and this together with the psychological effects of certain inflationary anticipations among the public has supported a consumption boom of impressive magnitude in Finland. Now that the rise in real income is slowing down, the consumption expenditure still has a tendency to increase, partly at the expense of savings. For the current year, volume of consumption is estimated to increase by some 2 per cent, or somewhat less than in 1962. The consumption expenditure which is particularly expansive in the sector of durable goods, has been a cause of concern to the authorities and continues to be a disturbing element in the monetary and balance-of-payments situation.

Monetary situation in Finland has been marked by a continued stringency of the money market, and it has been aggravated by fiscal developments. In the inflationary atmosphere which is prevailing in Finland, growth of savings by the public has not been very favourable. As a result, the banking system has been in constant debt to the Central Bank. By means of the strict control measures which the Bank of Finland has undertaken, the expansion of bank credit has, however, come to a halt and the private banks have been able even to reduce their rediscounts in the Central Bank. The budget situation is particularly difficult this year, as the deteriorating economic conditions necessitate large outlays for public works at the same time as the growth of revenue is slowing down. The financing of the expected cash deficit will require certain increases in indirect taxes and certain other measures, such as a compulsory loan from the public, in order to avoid disturbances in the cash situation of the Government.

In the general economic situation which I have described, the Finnish balance of payments is still a weak point. The rapid expansion of economic activity in the years 1960 to 1962 brought about an increasing balance-of-payments deficit which served an important function in absorbing excess demand at home and thereby alleviating the pressure of prices. In the present recession, the balance of payments is clearly improving but still remains in deficit. Although import demand is falling, particularly as far as investment goods are concerned, exports are no longer expanding, and even in more favourable conditions the aggregate export income will probably remain roughly on the same level as in 1962. The balance-of-payments deficit on current account will in no case reach the record level of last year, 291 million new Finnmarks, but will nevertheless amount to some 100 million marks.

In previous consultations in this Committee much attention was paid to the fact that Finland has been financing its balance-of-payments deficit since 1960 largely by borrowing abroad on short term. Thus, the foreign exchange reserves of the Central Bank have remained relatively stable and have not reflected the growing deficits. Possibilities for long-term borrowing abroad may have improved somewhat recently - evidence of this is provided by, for instance, a bond loan which Finland was able to place on the New York market last March - but it is unlikely that such borrowing will be sufficient to provide large-scale support for the balance of payments in the future. On the other hand, the Bank of Finland has introduced certain restrictions on short-term borrowing abroad. Thus it appears likely that the balance-of-payments deficit in the current year will be reflected more than before in a pressure against the foreign exchange reserves. It is unfortunate that it has not been possible to build up these reserves sufficiently in recent years their level being still very modest by any western European standards. As my Government is anxious to abstain from resorting to quantitative import controls in the present situation, the necessity to control the balance of payments without a reasonable "international margin" in the form of foreign exchange reserves, places a severe burden on the monetary and fiscal policies.

In spite of that, an effort has been made after the last consultations to proceed with further liberalization of the remaining restrictions. In the basic document and in the background paper prepared by the International Monetary Fund, these measures have been described in detail. I should particularly like to mention the fact that on 14 December 1962 the scope of the licence-free import system was extended by removing 340 tariff items and sub-items from the list of restricted commodities. The value of these imports amounted to some 35 million new Finnmarks.

Most of the imports still under control are admitted under the global quota system. In line with my Government's declared policy and in accordance with our international obligations, the amounts of these quotas have been increased every year. I am happy to report that as recently as last Monday, 10 June the list of quotas applicable for the full calendar year of 1963 was revised upwards. The new global quota programme amounts to 402 million Finnmarks

which, taking into account the imports liberalized at the beginning of the year, represented an increase of more than 10 per cent in the quotas. We consider this a reasonable progress in the present circumstances.

I should like to say a few words about one problem which appears to have caused some apprehension among our trading partners. As I mentioned a moment ago, the Bank of Finland introduced certain restrictions on the utilization of short-term foreign credits in order to check the rapid growth of Finland's short-term foreign liabilities. This was done mainly by limiting the possibilities of the commercial banks to accept deposits from abroad. Concern for the balance of payments and requirements of the monetary policy made it also necessary to put a brake on what monetary authorities considered to be an unduly strong expansion in commercial import credits and instalment sales of certain imported consumer durables. To achieve this, the Central Bank prohibited last October the utilization of import credits on a list of such products and payment for these imports must now be made before the goods can be cleared by the customs. Thus, importers of these goods must now obtain their financing through the internal credit market and they are subject to same credit restrictions as other clients of the commercial banks.

Mr. Chairman, I should like to conclude by stating that progress made in Finland in the relaxation of import restrictions during the recent months is attributable to careful consideration bearing in mind the continuously precarious state of the balance of payments. There has been no change in the declared policy of the Finnish Government to proceed with the elimination of the remaining restrictions as rapidly as the development of our balance of payments permits. I hope that the members of this Committee concur with our view that progress since last autumn has been reasonable in these circumstances.