Committee on Balance-of-Payments
Restrictions

DRAFT REPORT ON THE CONSULTATION UNDER ARTICLE XII:4(b)
WITH FINLAND AND EXAMINATION OF
IMPORT DEPOSIT SCHEME

1. In accordance with its terms of reference, the Committee has conducted a consultation with Finland under paragraph 4(b) of Article XII and has reviewed the Finnish Import Deposit Scheme. The Committee noted that the previous consultation with Finland under the same provisions had been held on 21 April 1975 (see BOP/R/79). In conducting the consultation the Committee had before it a basic document supplied by the Finnish authorities (BOP/162) and notifications of the Import Deposit Measures (L/4165 and Add. 1-5), a background paper provided by the International Monetary Fund dated 22 March 1976, and the text of a decision of the Executive Board of the International Monetary Fund taken on 31 March 1976.

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 29 April 1976. This report summarizes the main point 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:
After growing at 7.0 and 6.5 per cent in 1972 and 1973 respectively, the growth of real GDP in Finland slowed down to 4.4 per cent in 1974. In 1975, there was no growth in real GDP as the intensification of the international recession led to a decline in the volume of Finnish exports of 17 per cent. Domestic expenditure continued to grow relatively strongly mainly as a result of expansionary fiscal developments associated with a rapid increase in public expenditures. There was little reduction in the rate of inflation: consumer prices on average increased by 18 per cent during 1975 reflecting increases in wage earnings of 23 per cent and higher indirect taxes. The incomes policy agreement of February 1976 aims to reduce sharply the rate of inflation. The central wage agreement is consistent with an expected average increase in earnings of 13-14 per cent, and a five-month price freeze from February 1, 1976 followed by a period of strict price control is expected to result in consumer prices being 12-13 per cent higher on average in 1976 than in 1975.

Although there was little change in the terms of trade in 1974, the balance of payments deteriorated sharply with a trebling of the current account deficit to SDR 1 billion (equivalent to more than 5 per cent of GDP) as the volume of imports increased by about 7 per cent while export volume fell by about 1 per cent. In 1975 there was a further substantial increase in the deficit on current account to SDR 1.8 billion (the equivalent of over 8 per cent of GDP). The severity of impact of the recession in market economies on the current account deficit mentioned above, was tempered by a rise in export prices resulting in an 8 per cent improvement in the terms of trade, and by an increase of 46 per cent in the value of Finnish exports to the U.S.S.R. in 1975.

The current account deficits of the past two years were financed largely by substantial borrowing abroad, both long-term and short-term. Gross official convertible reserves showed little change in 1974 but there was an increase in Finland's debtor position under bilateral payments arrangements and a deterioration in the position of foreign exchange holders other than the Bank of Finland (i.e., commercial banks, Post Office Bank, and other financial institutions). In 1975, Finland moved into a strong net creditor position under bilateral payments arrangements but gross official convertible reserves declined by SDR 117 million to SDR 401 million at the end of the year, the equivalent of only about three and a half weeks of imports in 1975. In addition there was a further substantial rundown in net foreign assets held by other holders. At the end of February 1976, gross official convertible reserves had fallen by a further SDR 56 million and inconvertible foreign exchange holdings had increased by the equivalent of about SDR 27 million over their level at the end of 1975.
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).

In response to the worsening balance of payments situation, the Government announced in March 1975 a number of fiscal and monetary measures, which included the imposition of a temporary import deposit requirement effective March 24, 1975. This provided that certain commodities were to be released by the customs authorities only on payment into a special non-interest bearing account with the Bank of Finland of a deposit equivalent to between 5 per cent and 30 per cent of the c.i.f. value of the imports, depending on the commodity. Such deposits would be released after six months. The maximum deposit rate of 30 per cent was applied to virtually all consumer goods, while, in general, investment goods were subject to a rate of 10 per cent or 20 per cent and raw materials and production necessities were subject to a rate of 5 per cent or 10 per cent. It is estimated that half of total imports were covered by the scheme, that the weighted average deposit rate was about 20 per cent and that the weighted average extra cost of imports due to the scheme was only about 2 per cent. Its primary impact on imports was expected to take place through a tightening of the domestic financial market. The original intention of the Government was to begin to relax the requirement gradually as soon as possible and to terminate it completely by March 24, 1976.

The deposit on goods subject to a rate of 5 per cent was abolished on February 15, 1976, but the Government announced on March 15, 1976 that in the light of the difficult balance of payments situation in which Finland continued to find itself and the implications for domestic liquidity, it could not adhere to its original intention and had decided instead to phase out the system in the following way: with respect to those commodities then subject to a 20 per cent rate of deposit, to reduce the rate to 10 per cent on March 16, 1976 and to abolish the requirement on July 1, 1976; with respect to those commodities subject to a 10 per cent rate of deposit, to abolish the requirement also on July 1; and, with respect to those commodities subject to a 30 per cent rate of deposit, to reduce the rate to 20 per cent on October 1, 1976, to 10 per cent on November 16, 1976, and to abolish the requirement altogether on December 31, 1976. It was estimated that of the Fmk 1.5 billion of import deposits outstanding at the end of February 1976, about one third would be released during 1976 and the remainder by the end of July 1977.
"To cope with Finland's serious payments problems, the authorities have adopted a number of other measures including restrictive fiscal and monetary measures designed to reduce the current account deficit, and to curb inflation while also sustaining employment. These measures take into account the impact on domestic liquidity of the announced schedule for relaxation and termination by December 31, 1976 of the import deposit requirement. The Fund believes that in view of the low level of Finland's external reserves, the extension of the import deposit requirement until December 31, 1976 does not go beyond what is necessary to prevent a further fall in the level of reserves."

4. In his opening statement the full text of which is contained in the Annex, the representative of Finland said that the 1975 recession experienced by developed market economies had led to a rapid deterioration of the balance of payments in Finland. In the course of the year a drop of 17 per cent in the volume of commodity exports, combined with unchanged import volumes, had resulted in a large trade deficit. The fall in the volume of exports had been so large that not even the considerable rise in export prices had prevented the value of exports from diminishing. Employment had started deteriorating towards the end of the year and inflation had risen to an unacceptable level. According to preliminary estimates the current account of the balance of payments showed a deficit exceeding 8 per cent of Finland's GDP in 1975. About two thirds of the current account deficit had been financed by the import of long-term capital and most of the remainder through short-term capital inflows. The balance had been financed from foreign exchange reserves which had fallen from 1.7 billion Finnish markkaa at the end of 1974 to 1.4 billion at the end of 1975. At the end of March 1976 the convertible foreign exchange reserves of Finland stood at 1 billion markkaa, about two weeks' imports, which was very low by international standards.
5. It had thus been necessary to pursue simultaneously several possibly conflicting objectives: adequate employment, reduction of the current account deficit and of the rate of inflation. A reasonable outcome of all these elements would depend on the performance of exports which again depended on the rate of recovery Finland's principal markets. The Government had given high priority to employment but did not intend to give up the tight line followed in fiscal policy and was even prepared if necessary to intensify it. Fiscal policy would be used in such a way that the necessary finance would be directed to those investment projects which were liable to help balance foreign trade and promote employment. Central Bank credit quotas had been lowered and a more restrictive attitude taken toward capital imports. Tight domestic monetary conditions would also be maintained. In the opinion of the Finnish authorities there was not much more room for greater monetary stringency. The degree of present monetary restraint was such that additional curbs would retard excessively the growth of domestic production and employment.

6. With regard to prospects for 1976 the representative of Finland said that a gradual recovery of economic activity was expected towards the end of the year. Volume of exports of goods and services was expected to grow by some 13\(^\frac{1}{2}\) per cent, which would still be lower than the 1973 level. The rise in export prices was forecast at 3\(^\frac{1}{2}\) per cent (compared to 16 per cent in 1975). The volume of domestic demand was expected to fall off by some 4 per cent. This in turn was expected to reduce the volume of imports. Nevertheless a current account deficit of Fmk 5 billion, some 4\(^\frac{1}{2}\) per cent of GDP, was expected and considered excessively high. No growth was expected in total output. Despite improvements in the balance-of-payments the
prompt notifications to GATT by the Finnish authorities of all changes that had taken place in the operation of the scheme. They also thanked the Finnish delegation for the up-to-date and comprehensive documentation that had been submitted to the Committee. It was noted that although it had been expected that the import deposit scheme would be eliminated by 31 March 1976, the termination had been postponed until the end of 1976. During the year the deposit scheme would be phased out gradually.

10. Noting that the balance-of-payments situation of Finland had continued to deteriorate through 1975 and in particular that the deficit on current account had worsened and reached the equivalent of 8 per cent of Finland's GDP, members of the Committee asked what the prospects were for developments in 1976. It was appreciated that the very diverse elements at work in the present economic situation of most countries made forecasting difficult. Nevertheless the gradual economic revival which was taking place in some countries could be expected to have some bearing on Finland's balance-of-payments in 1976. It was also noted that on the export side Finland relied on a limited number of products and it was asked how the prices for these products were expected to behave during the current year. The representative of Finland stressed that the current account deficit in 1975 had indeed then been very large by any international standard. It had reached in 1975 Fmk 7.9 billion; it was expected to be reduced in 1976 to some Fmk 5 billion. However, this would depend on how it could be financed. He pointed out that on the export side volumes had fallen by 17 per cent in 1975; this was a higher figure than for any other developed economy during that period. It was expected that the volume of Finnish exports would show some growth in 1976. The drop in volume had been particularly severe in traditional Finnish export
products such as wood, pulp and paper; but economic forecasts showed that some recovery in world demand would take place towards the end of 1976. This demand which had fallen by one-third in 1975 was expected to grow again by some 20 per cent in 1976. The export of engineering products had shown little growth in 1975. For 1976 a growth of some 14 per cent was foreseen. Total export prices had risen by 18 per cent in 1975, but for 1976 only a minor increase was expected. While there had been a sharp fall in the volume of exports in 1975, the value had fallen only slightly. In 1976 the value was foreseen to rise by 18 per cent; the largest increase was expected in the pulp and paper sector and also in engineering products. The representative of Finland added that all forecasting was subject to the uncertainties of cyclical developments in other economies, and, under the present circumstances, was at best an uncertain exercise. On the import side the fall in the volume of imports in 1975 reflected the reduction of domestic demand. For 1976 no increase was expected in domestic demand. He pointed out that the past few years had seen a high level of economic activity and that it was normal that Finland experienced a levelling out of domestic demand in this phase of the cycle. He added that despite the rise in import prices Finland's terms of trade had not deteriorated due to favourable developments in export prices. Few changes were expected to take place in 1976 in the value of total imports; however some changes were expected in the composition of imports (more petroleum products and less investment goods, with almost no change in consumer goods).
11. In reply to questions concerning the exchange rate policy of Finland and the suggestion that exchange rate stability might make the achievement of balance-of-payments equilibrium difficult in the future, the representative of Finland replied that this was a question of the relative competitiveness of Finnish products. He pointed out that relative unit cost in Finland had risen faster than in other countries; on the other hand export unit values had also increased rapidly and the profitability of the major export sectors could be regarded as adequate. An exchange rate change would not, under these circumstances, lead to an increase in exports.

12. Members of the Committee asked questions concerning the servicing of Finland's foreign debt. The representative of Finland explained that by the end of 1975 Finland's net foreign debt had risen to 21 per cent of GDP (this comprised both the short and long-term debt) during 1975. At the same time there had been an increase in the relative share of short-term capital in the debt. The Finnish authorities felt that it would be necessary to put a stop to further growth in Finland's foreign debt. This implied that future current account deficits would have to be considerably reduced. He added that the debt service ratio for the long-term debt had moved from 9 per cent in 1974 to 10 per cent in 1975.

13. Several questions were asked on the possibilities of export diversification. The representative of Finland said that his authorities considered this to be an important field and added that there had been rapid developments in export diversification during the sixties and early seventies when new sectors had been
added to Finland's traditional lines such as metal and engineering products and various consumer goods. However, this diversification had been over-shadowed by the recent rise in export prices for Finland's traditional exports (wood, pulp and paper); thus in the past year or so there had been an increase in the volume of Finnish non-traditional exports which had not been reflected in its share of total export. On a value basis it was asked whether the government's encouragement of capital goods imports and investments had led to a significant increase in Finland's export capacity for non-traditional products. The representative of Finland said that this had been reflected in the increase of volume in the export of engineering and consumer products. He pointed out that the restructuring of Finnish exports required huge investment goods imports; the continued growth of capital goods import was now hampered by the difficulties in the balance of payments so that further investments in capital goods directed to export diversification would have to slow down.

14. Asked to comment on the government's guidelines on giving priority to investments that helped the balance of payments and curbed investments in services, the representative of Finland said that the Bank of Finland had issued guidelines to the commercial banks to give priority in the allocation of credit to profitable investments in export industries. He added that in the future limits might have to be put on the growth of such investment in order to reduce the current account deficit. Working capital could be supplied to industries with good market prospects in order to maintain employment.
15. Questions were asked concerning Finland's rate of inflation in recent years which compared unfavourably to other Western countries. In particular it was asked whether any measures were envisaged to reduce the rate. The representative of Finland said that during the past two years the rate of inflation has been of the order of 17-18 per cent per annum, this obviously could not be sustained in view of the relative competitive position of Finnish production vis-à-vis other countries. In February of 1976 a new incomes' policy agreement had been reached; thus wages had been increased by 7 per cent for the next twelve months. This settlement included a price freeze which would last until the end of June 1976. No prices would be allowed to rise, except for some agricultural and other products agreed on earlier. This price freeze had been in effect for two months now and the rate of inflation had slowed down. When the price freeze would end in June 1976 there would be tight price control measures taken for the remainder of the year. This would cover a number of products and it was hoped that as a result there would be a deceleration in the rise of consumer prices in 1976.

16. In reply to questions concerning energy saving measures the representative of Finland said that his authorities were aware of the importance of this field. He pointed out that out of total imports in 1975 of Fmk 28 billion, Fmk 5 billion had been for crude oil and fuel. Energy saving measures had been adopted and the development of domestic energy resources had been encouraged. However Finland remained very dependent on imported energy; furthermore its climate made it very vulnerable as much of the fuel was used for heating homes. Domestic energy
resources consisted mainly in the greater use of peat and of nuclear power. Production of hydroelectricity could not be significantly increased in Finland. Priority had been given for investment in projects using domestic fuels and in the building of nuclear power plants. Energy savings had been encouraged and was directed mainly at improving heating efficiency. It was estimated that all these measures could achieve a 10 per cent saving of energy, at a value of some Fmk 1 billion. It was stated that these measures should, at best, lead to a 10 to 15 per cent permanent reduction of energy consumption.

17. Turning to the question of Finland's tight money policy, questions were asked concerning the impact of the import deposit scheme or the level of liquidity in the economy. It was also asked what effect the scheme had had in reducing the volume of imports. The representative of Finland said that the effect on the volume of imports had been very small. It was estimated that about one third to half of the total deposits had been financed through short-term capital imports.

18. In reply to a specific question concerning the Bank of Finland's policy towards import credits the representative of Finland replied that measures had been taken to discourage import credits of more than six months. Thus import credits exceeding six months were subject to a progressive levy. Any credits exceeding one year were in any case subject to central bank authorization. The purpose of this measure was to reduce the potential for short-term capital inflows. However, it was not expected that this measure would induce great changes in import credits.
Clarification was sought concerning the share of trade with socialist countries in Finland's total trade. The representative of Finland replied that with regard to exports in 1975, which had amounted to some Fmk 20 billion, Fmk 4.9 billion had gone to socialist countries. Of this amount 4.2 billion had consisted of exports to the Soviet Union and 58 million to the Peoples Republic of China. Imports for the same year had amounted to some Fmk 28 billion, of which 5.9 billion had come from socialist countries; of this amount 4.7 billion were imports from the Soviet Union and 85 million from the Peoples Republic of China.

Parts III and IV System and Method of the Restrictions and Effects of the Restrictions

20. The Committee noted that the import deposit scheme introduced under the Import Deposit Act of 22 March 1975 had not been terminated as expected on 31 March 1976 but had been prolonged until 31 December 1976. A schedule for the gradual termination of the scheme had been announced on 15 March 1976; the 20 per cent category was reduced to 10 per cent on 16 March; the 10 per cent category would be abolished on 1 July. The maximum rate would be reduced to 20 per cent on 1 October 1976 and to 10 per cent on 16 November 1976 and the requirement would be terminated on 31 December 1976. It was recalled that the deposit on goods subject to the rate of 5 per cent had been abolished in February 1976. While members of the Committee regretted that termination had been postponed they welcomed the announcement of a detailed schedule of termination and the gradual reduction of the rates. It was noted with satisfaction that the scheme continued to be applied on a non-discriminatory basis.
21. On the question of exceptions to the import deposit scheme, under Article 13 of the Act, questions were asked concerning the criteria adopted to qualify for exceptions and on the extent of these exceptions. The representative of Finland said that exceptions were given by special permission of the Government. He pointed out that up to the period 12 April 1976 there had been some 1,552 applications for exemptions of which half had been approved. The bulk of the value of exemptions approved concerned imports for nuclear power plants and other large investment projects. He reiterated that there was no discrimination as to the source of imports. Total exceptions in the twelve-month period since the deposit scheme had been introduced were estimated at a value of Fmk 4 billion. In reply to further questions the representative of Finland said that his authorities when introducing the scheme had considered necessary to give some priority to essential goods such as raw materials and investment goods, and had done so by either exempting them from the scheme or by subjecting them to lower rates. Thus mineral fuels, ores, certain pharmaceuticals, iron and steel were not subject to a deposit requirement. One member of the Committee asked whether the representative of Finland would provide a breakdown of imports which had been granted entry into Finland as exemptions under Article 13 of the Import Deposit Act since the introduction of the Act. He requested if possible that such a breakdown be provided according to value of imports from market economy countries; value of imports from State-trading countries; and value of imports from State-trading countries with which Finland has free trade agreements. The representative of Finland replied that no such breakdown were available as exceptions were not granted on
the basis of country of origin but given on the merits of each case. Exceptions granted were mainly in the area of large investment projects and the origin of imports effected had always been made on purely commercial grounds.

22. Although the scheme was non-discriminatory as to source of imports, members of the Committee asked whether certain supplier countries were not more effected by the deposits than others. The representative of Finland replied that the rates of the deposits had not been fixed according to the country of origin of the goods but according to the essentiality of the goods. The extent to which different countries would be affected depended on the composition of imports from these countries.

23. It was further asked whether there was any breakdown by percentage of imports in each category of deposit rates. The representative of Finland replied that as there had been no changes in the product coverage of the scheme, approximately half of total imports were still subject to the deposit requirement after the relaxation effected on 16 March 1976. About 61 per cent of imports subject to the requirement were in the 30 per cent category and the remaining 39 per cent in the 10 per cent category. With the abolition of the 10 per cent category on 1 July 1976 the coverage of the deposit scheme would decline to 30 per cent of total imports.

24. The representative of Finland was asked to comment generally on his authorities' experience with the import deposit scheme and in particular on its effects on internal liquidity on the one hand and on the volume of imports on the other hand. The representative of Finland replied that some Fmk 1.5 billion had been accumulated through the import deposit scheme. Of this it was estimated that
one third to one half had been financed by short-term exporters' credits. The import deposit scheme should be considered as a selective instrument to control liquidity as it has not significantly affected the volume of imports. Some members of the Committee remarked that if the import deposit scheme was aimed primarily at reducing the level of internal liquidity it also affected imports by raising their costs; if a tight money policy was pursued then it should be accompanied by measures that affected other sectors than imports. The representative of Finland explained that other measures had been taken to restrict liquidity, i.e. by reducing commercial banks' Central Bank credit quotas.

25. Members of the Committee recalled that the Bank of Finland had taken measures to prohibit recourse to foreign and domestic credit to finance the deposits. However if one third to half of the deposits accumulated had in fact been financed through short-term exporters' credits it was questionable whether these measures had had the desired effects.

26. One member of the Committee commenting on the existence of quantitative restrictions for agricultural products asked how Finland justified the fact that the import licensing system was aimed mainly at these products and for what reasons imports of goods in one sector should be restricted to a greater extent, on balance-of-payments grounds, than goods in other sectors. The representative of Finland pointed out that the licensing concerned covered only a small sector of the economy and that the measures were maintained for balance-of-payments reasons, under Article XII of GATT.
27. In reply to a question whether Finland would continue as in the past to make foreign exchange available for imports of items subject to global import quotas in excess of the indicative level of the quotas when there was pressure for additional imports, the representative of Finland said that the practice would continue within the limits of availability of foreign exchange and would be kept under review.

Conclusions

Import deposits

28. The Committee expressed understanding and sympathy for the Finnish balance-of-payments situation and the various objectives the authorities were attempting to attain. While it regretted that the import deposit scheme could not be terminated in March 1976 the Committee welcomed the established programme to phase out the scheme by reducing the rates gradually in view of final termination on 31 December 1976. The Committee noted the need to keep the matter under review. The Committee took into account the finding of the International Monetary Fund to the effect that in view of the low level of Finland's external reserves the extension of the import deposit requirement did not go beyond what was necessary to prevent a further fall in the level of reserves. The Committee noted with interest that the primary aim of the import deposit scheme was one of liquidity control rather than reduction of volume of imports. Finally the Committee expressed the hope that the economic conditions in Finland and on the international markets would improve sufficiently in the course of 1976 to allow Finland to redress the disequilibrium in its balance of payments.

Import restrictions

29. The Committee noted that Finland maintained quantitative restrictions for certain products and that it invoked the provisions of Article XII to justify the maintenance of these restrictions.