

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED
Spec(78)14
29 May 1978

Committee on Balance-of-Payments Restrictions

DRAFT 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 24 May 1977 (see BOP/R/95). In conducting the consultation the Committee had before it a basic document supplied by the Finnish authorities (BOP/184) and a background paper provided by the International Monetary Fund dated 1 May 1978.

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 23 May 1978. 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:

"Real GDP is estimated to have declined by more than one half of 1 per cent in 1977 after rising only marginally in the two preceding years. Restrictive demand management policies implemented from mid-1975 onward contributed to a fall in the volume of domestic demand by 7-8 per cent between 1975 and 1977; real fixed investment declined by 18 per cent and real consumption fell by 2 per cent. During this period, the volume of imports of goods and services also fell by over 10 per cent, and, aided by a recovery of demand in Finland's major export markets, the volume of exports of goods and services rose by over 22 per cent. However, since export demand was met largely from inventories, the improvement in the real foreign balance only compensated for the fall in domestic demand, and output stagnated.

"These developments were accompanied by a sharp increase in the level of unemployment, which was further intensified during 1977 by a shake-out of previously hoarded labor, and reached over 7 per cent (seasonally adjusted) by the end of the year. The weakness in the labor market helped to moderate the rise in domestic costs. The growth of unit labor costs declined from 23½ per cent in 1975 to 9 per cent in 1977. Nonetheless, Finland's competitive position still deteriorated in 1976. In 1977, two depreciations of the markka totaling 8.7 per cent were in large part responsible for a reversal of this trend. Despite sizable increases in indirect taxation and the exchange rate changes, the rise in consumer prices slowed from 18 per cent in 1975 to 12½ per cent in 1977. The increase in consumer prices projected for 1978 is 8 per cent.

"In response to the rapidly deteriorating employment situation, and aided by a substantial improvement in the balance of payments, policies were cautiously shifted in a more expansionary direction in mid-1977. In December, a package of measures designed to further reduce the rate of inflation and to stimulate economic growth was introduced, including inter alia, the postponement of wage increases due in 1978, an eight-month price freeze and an expenditure program for the support of employment. In February 1978, in response to developments in exchange markets including the decline in value of the U.S. dollar, the markka was further depreciated by 8 per cent. Some wage compensation was subsequently granted by bringing forward part of a previously postponed wage increase, while the impact on corporate costs was offset by fiscal concessions designed to reduce nonwage costs. In the absence of a sharp upswing in export demand, there is expected to be little growth in real GDP in 1978 for the fourth consecutive year. Private fixed investment will continue to fall and unemployment is expected to rise further.

"There has been a remarkable improvement in Finland's balance of payments position over the past two years as, despite a 4 per cent deterioration in the terms of trade and higher debt servicing costs, the deficit on current account was reduced from SDR 1.8 billion (8 per cent

of GDP) in 1975 to SDR 0.2 billion ($\frac{1}{2}$ per cent of GDP). In 1977 a surplus on trade account was registered for the first time since 1968. However, this improvement was in large part a reflection of the domestic recession and the resulting low level of the demand for imports. The volume of merchandise imports fell by 4 per cent in 1976 and by over 8 per cent in 1977. In 1976 the volume of merchandise exports increased by 17 per cent from the exceptionally low level reached in 1975; in 1977 it grew by about 10 per cent as the economic recovery in Finland's main trading partners slowed. In 1978, depressed domestic demand will again limit the growth of imports and a further improvement in both the trade balance and current account is expected.

"Coinciding with the improvement in the current account, net inflows of capital declined considerably during 1976-77, in part reflecting stricter surveillance of long-term foreign borrowing by the Bank of Finland and a decrease in net short-term trade credits associated with movements in merchandise trade. In addition, short-term capital outflows accelerated toward the end of 1977 due to uncertainty regarding the external value of the markka. Overall, net capital inflow amounted to SDR 0.9 billion in 1976 and an unusual net outflow of SDR 0.1 billion occurred in 1977. Consequently, there was an overall balance of payments deficit in both years, and net international reserves declined by SDR 0.1 billion in 1976 and by SDR 0.3 billion in 1977. Gross official convertible reserves, however, increased by SDR 28 million in 1976, entirely owing to a drawing of SDR 115 million under the IMF's oil facility, and rose by SDR 40 million in 1977 reflecting drawings of some SDR 250 million on lines of credit with foreign commercial banks. At the end of 1977, gross official convertible reserves amounted to SDR 469 million, the equivalent of about one month's imports from the multilateral area. The equivalent of SDR 107 million was also held in inconvertible currencies under bilateral payments arrangements, amounting to some 7 per cent of bilateral imports. In the first quarter of 1978, official foreign borrowing and a reflow of short-term capital following the February depreciation of the markka contributed to a rise in gross official convertible reserves to SDR 731 million at the end of March, equivalent to about two months' multilateral imports.

"Finland maintains global quotas and individual licensing in respect of certain agricultural products, mineral fuels, and unwrought gold and silver when imported from the multilateral area.

"Over the past two years there has been a substantial strengthening of Finland's external position and some further improvement is expected in 1978. If these trends continue it will become difficult to justify the maintenance of the present import quotas and licensing on balance of payments grounds. The Fund appreciates, however, that there may be other reasons, including commercial policy considerations, for the maintenance of these restrictions."

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 improvement in the Finnish current account between 1976 and 1977. He pointed out that the extremely low level of domestic demand had caused the current account to improve far more than the underlying balance-of-payments position would warrant. The volume of Finnish exports of goods and services had increased in 1977 but had not been large enough to compensate for a fall in domestic demand and the volume of gross domestic product had decreased by 1 per cent. Restrictive economic policies had to some extent reduced the rate of inflation. However, consumer prices continued to rise at an annual rate of 12 per cent in 1977. The prolonged period of slow growth and the subsequent fall in production had brought about an unprecedentedly high level of unemployment. In both 1976 and 1977 the contraction in domestic demand had resulted in a reduction in the volume of imports of goods and services. The fall was most notable in imports of raw materials and in particular investment goods. In 1977 the trade account had moved into surplus for the first time in ten years. He described the developments in the level of Finland's reserves of foreign exchange, and pointed out that Finland's net foreign debt had risen to Fmk 27 billion or $22\frac{1}{2}$ per cent of GDP by 1977. He added that the outlook for the economy was unfavourable in 1978 and that there was little scope for expansion. Since 1975 the authorities had aimed at eliminating permanently the imbalances in the economy. At first restoration of external balances and checking of inflation had been given priority. Recently because of the sharp increase in unemployment economic policy had more than before been geared to the promotion of production and employment. However, it was forecast that growth of production would be insignificant in 1978 despite the various measures adopted.

5. He reiterated the Finnish Government's full support for the principles of free trade. He added that the balance-of-payments adjustment of the past few years had been achieved without the aid of any net intensification of trade restrictions. On the contrary, the temporary import deposit scheme had been abolished and the coverage of the cash payment scheme had recently been reduced. The brunt of adjustment had been borne by the domestic economy with heavy costs in terms of unemployment of resources on a large scale. It was obvious that there was a large pent up need for investments in new productive capacity and restructuring of industry as soon as export prospects brightened. Once international developments become more favourable the Finnish balance of payments would undoubtedly come under renewed pressure. Therefore, in the opinion of the Finnish Government 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

6. 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 co-operative attitude of Finland in the consultations and in the notification of changes in its import régime was much appreciated. The members of the Committee noted and welcomed the improvement in the balance-of-payments situation of Finland. For the first time since 1968 there had been a surplus in the trade account; the current account was in a good position and the preliminary figures for 1978 indicated a favourable trend toward further improvement of the balance of payments. It was appreciated however, that not all the factors that had contributed to the improvement of the balance of payments were positive; domestic recession, slack internal demand for imports and a high rate of unemployment had played a large part.

7. Members of the Committee also noted that there had been some improvement in the gross official convertible reserves of Finland which at the end of March 1978 stood at the equivalent of about two months multilateral imports. The representative of Finland pointed out that there had been some sharp movements in the level of reserves in the latter part of 1977. Reserves which had stood at some Fmk 650 million in August 1977 before the devaluation of the Finnish markka had been completely depleted by November 1977; this had prompted the Bank of Finland to draw on special credit lines that it had negotiated with private foreign banks. By the end of the year the reserves stood at a more acceptable level and there had been a marked reflow of short-term capital early in 1978. A further devaluation of the markka in February-March of 1978 re-established confidence in the Finnish currency and by the end of April 1978 reserves stood at Fmk 2.8 billion, almost half of which consisted of funds drawn from the special credit line arrangements with consortia of banks. He pointed out that this rise in reserves did little else but restore the level of reserves of previous years. By any definition the Finnish reserves had always been low and were considered inadequate, and at some 7 per cent of imports they stood much lower than the reserves of comparable countries such as Nordic countries. There was some discussion of what constituted an adequate level of reserves and it was generally appreciated that no rigid criteria could be applied. Adequacy of the level on reserves had to be assessed against such factors as the nature of reserves, the definition used such as gross or net and official or private reserves, the fluctuations in a country's access to credit and its exchange system. Three to four months exports and import reserves were often considered adequate, but some countries held that two months reserves were enough.

8. Several questions were asked concerning the prospects seen by the Finnish authorities for 1978 in the areas of economic expansion, balance of payments, the level of inflation and the various factors that could influence these areas such as wages and salaries agreements. The representative of Finland said that forecasts for gross domestic production in 1978 indicated hardly any change from the previous year. For the second time only in thirty years there had actually been a fall in aggregate production in 1977 and GDP had fallen by 0.7 per cent compared to 1976. There was little scope for any expansion of the economy. The forecasts for economic expansion in Europe were generally very low and it was expected that this would affect Finland directly. Exports were expected to continue to grow in 1978, but at a slower rate, while imports were expected to remain sluggish. The principal reason for the continued fall in imports was slack domestic demand.

9. Turning to the question of unemployment, members of the Committee noted that Finland favoured sector wages and salary agreements negotiated with trade unions under the guidance of a State-appointed income policy negotiator. They noted new agreements were due to be negotiated in 1979 and asked whether the authorities, in view of the present level of unemployment and general economic conditions, would be able to fulfil its aim of reducing unemployment to below 2.5 per cent by 1980. It was asked what measures the authorities would adopt to reach this aim. The representative of Finland said that while his authorities had had a measure of success in improving the current account of the balance of payments and had also met some moderate success in curbing inflation, it had had no success in reducing the level of unemployment. It was not expected that it would be possible to reach a level of less than 2.5 per cent unemployment by 1980.

10. Members of the Committee noted that in December 1977 Finland had introduced a package of measures which, inter alia, included the promotion of exports. It was noted that there were provisions for the Bank of Finland to participate in the financing of exports and it was asked in this context whether this did not carry a risk to counteract the effects of the restrictive monetary policy now in force. The representative of Finland replied that while there was no conscious policy of export diversification the Finnish economy had undergone a structural change and that the share of traditional exports showed no growth while new export items such as consumer goods and engineering products had more than doubled. Government measures to promote exports were aimed at intensifying efforts to reach markets which had effective purchasing power such as oil-producing countries and growing economies such as South Korea and certain countries in Latin America. To this end the Government had enlarged its network of commercial secretaries and had intensified export promotion through trade missions and participation in fairs. The results have been encouraging. It was also asked whether any changes had been introduced to the export cost inflation insurance scheme as a result of improvements in the balance of payments. The representative of Finland said that the scheme was self supporting and that there had been no changes since the last notification by his authorities to the GATT Working Party on the subject in 1977 (L/4552).

11. Some questions were asked on the drawings by Finland on the IMF's oil facility and in particular the amount of official foreign borrowing in the first quarter of 1978. In reply the representative of Finland confirmed that his authorities had drawn 71.25 million SDR's in 1975 and 115.1 million SDR's in 1976. At today's dollar exchange for the SDR these figures represented \$225 million and were included in the figures for Finland's foreign exchange reserves. No further drawings had been effected after 1976.

Parts III and IVSystem, methods and effects of the restrictions

12. Members of the Committee noting the improvements in the balance-of-payments situation and particularly in the trade account, expressed the hope that the time would soon come when Finland no longer needed import restrictions. Some members questioned whether, in view of the balance-of-payments improvements, restraints were warranted and asked the Finnish Government to develop a time-schedule for their gradual removal.

13. Several questions were asked on the cash payment scheme which Finland had introduced in 1973 as a monetary policy instrument designed to bring about a shift in the share of short-term foreign borrowing in favour of long-term capital imports. The representative of Finland commented that it was also part of a general tight money policy and as such had put domestic producers on the same footing as importers. The situation had changed since then. There had been improvements in the balance-of-payments situation which opened the way to a shift from tight money policy towards expansion. Thus the cash payment scheme coverage had been reduced by 4.5 per cent and at present covered only some 2.5 per cent of imports. Recently, items such as certain raw materials, vulcanized products, chemicals, machinery equipment and certain foods had been removed from the list of cash payment requirements. In reply to questions about the termination of the scheme the representative of Finland said that the Bank of Finland kept a close watch on the situation and reviewed periodically the list of goods affected in the light of developments in the monetary position. No decision had been taken

as to the removal of the scheme. Asked to comment on whether the scheme had been successful in reducing short-term foreign indebtedness the representative of Finland said that it had indeed been effective as a tool to promote long-term capital loans. He added that this tool of tight money policy had also been instrumental in the general improvement of the balance-of-payments situation. Members of the Committee welcomed the reduction of the coverage of the cash payment scheme but expressed concern as to its possible effects on trade. It had great similarities with prior deposit schemes in so far as the cash payments were due before customs clearance. It was specifically asked whether the coverage would be further diminished in parallel with further improvements in the balance of payments; and whether the Finnish authorities envisaged introducing a time schedule to phase the measure out. It was noted that although described as a purely monetary measure, Finnish authorities appeared to see a clear link between the scope of the cash payment scheme and the prevailing balance-of-payments situation. Members of the Committee also pointed out that the scheme could have import substitution effects for certain products. The representative of Finland reiterated that the purpose of the cash payment scheme was to alter the structure of foreign indebtedness between short-term and long-term capital inflows. The coverage of the scheme affected mainly consumer goods; however, his authorities could not comment upon any secondary effects on trade. No time schedule for phasing out the scheme was expected to be introduced. However, it was under careful review by the Bank of Finland with a view to further limiting the coverage.

14. Members of the Committee noted that Finland still maintained global quotas on 0.7 per cent of its total imports and individual licensing on 9.2 per cent of total imports. They noted that whereas imports admitted without license had declined from 68.4 per cent in 1976 to 66.4 per cent in 1977, the imports subject to individual licensing had risen from 8.9 per cent in 1976 to 9.2 per cent in 1977 and asked whether this reflected the tightening of restraints or whether there were any other reasons. It was also asked whether the Finnish authorities had any estimate of the increase in imports to be expected if the system of quotas and individual licensing were abolished or liberalized and to what extent present restraints had limited imports in the past year. Noting that the granting of individual licences was based on the availability of foreign exchange it was asked whether this criteria had lead to any refusal of licences. Referring to the conclusions of the previous consultation, the representative of Finland was asked to comment on the rôle of other than balance-of-payments reasons for applying import restrictions. The representative of Finland said that the individual licensing régime had always been applied in a liberal manner; The criteria of availability of foreign exchange had never been used for refusal of licences, because foreign exchange had always been available. He specified that the increase from 8.9 per cent to 9.2 per cent of the share of imports under individual licensing indicated an increase of imports. Noting that individual licensing had been introduced in 1973 as a temporary measure, it was asked whether a termination date was now envisaged. The represenative of Finland stressed that the removal of these restrictions

would have an immediate effect on the balance of payments. He pointed out that as regards oil imports the system was designed to balance the trade account with the USSR. He was not in a position to elaborate on the possible effects on imports of the elimination of these restrictions.

15. Members of the Committee asked for clarification on the applicability of the global quota and individual licensing régime to imports from other than the multilateral area. It appeared from the documentation before the Committee that neither the global quota system nor the individual licensing system applied to the non-multilateral area. If this were the case it would be a discrimination in favour of non-multilateral countries and incompatible with the provisions of GATT Articles XII and XIII. The representative of Finland recalled that imports from socialist countries of products exempted from licensing amounted to less than 1 per cent of total imports from these countries. Quantitative restrictions were generally applied to all imports. He pointed out that the agreements Finland had entered into with socialist countries were being examined in the GATT in the light of Article XXIV. Members of the Committee pointed out that the application of balance-of-payments measures under Article XII had to be non-discriminatory and that agreements entered into under Article XXIV did not constitute entitlement to exemption from restrictions taken on balance-of-payments grounds under Article XII. The representative of Finland took note of the relationship as stated between the provisions of Article XII and Article XXIV.

15. bis. Members of the Committee asked for clarification on the applicability of the global quota and individual licensing régime to imports from other than the multilateral area. It appeared from the documentation before the Committee for certain specific products countries having free-trade agreements with Finland (EC, EFTA, some socialist countries) were exempted from the application of the licensing requirement for these particular products. If this were the case it would be a discrimination in favour of those countries and incompatible with the provisions of GATT Article XII and XIII. The representative of Finland recalled that imports from socialist countries of products exempted from licensing amounted to less than 1 per cent of total imports from these countries. Quantitative restrictions were generally applied to all imports. He pointed out, however, that the free-trade agreements Finland had entered into with were the EC, EFTA and some socialist countries; recent agreements with some socialist countries were being examined in the GATT in the light of Article XXIV. Members of the Committee pointed out that the application of balance-of-payments measures under Article XII had to be non-discriminatory and that agreements entered into under Article XXIV did not constitute entitlement to exemption from restrictions taken on balance-of-payments grounds under Article XII. The representative of Finland took note of the views expressed by some members of the Committee regarding the relationship as stated between the provisions of Article XII and Article XXIV, but maintained its view that free-trade agreements concluded under Article XXIV could contain exemptions from the application of quantitative restrictions.

16. The members of the Committee noted that on 10 March 1978 the Finnish authorities had introduced a system of surveillance licensing for certain goods. The representative of Finland stated that this surveillance licensing covered textiles and steel products - BTN chapters 60-64 and BTN chapter 73. Its purpose was to get early information and to follow more closely developments in these two sensitive areas. It involved no quantitative restrictions. Licences were issued within three to five days of request. It was applied on a non-discriminatory basis with the exception that it did not apply to imports from countries with which Finland had free-trade agreements.

17. A specific question was asked concerning the possibility for relaxation of import restrictions in the future on the importation of apples, meat and canned fruit. In reply the representative of Finland said that practically no meat was imported into Finland and that with regard to apples there was a quota for the importation of southern hemisphere apples for the month of 1 January to 31 May.

Conclusions

18. The Committee welcomed the marked improvement in Finland's balance-of-payments and reserve position, and also the further improvement that was expected in 1978. It questioned whether the existing level of trade restrictions would continue to be warranted on balance-of-payments grounds should the favourable trend be maintained. It therefore recommended that Finland initiate the process of relaxation of its import restrictions in parallel with the strengthening of its external position.

19. The Committee noted that the coverage of the cash payment scheme had been reduced and invited the Finnish authorities to further relax this measure which, though primarily of a monetary nature, could be detrimental to trade by its possible import substitution effects.

20. Some members of the Committee recalled that measures applied under Article XII were subject to the provisions of Article XIII, and that exceptions to non-discriminatory administration of trade restrictions were governed by Article XIV. Other members added that this was without prejudice to other provisions of the General Agreement.