



[Bank of Finland]

BULLETIN

BANK OF FINLAND

Suomen Pankin kirjasto



0000028347 IVA5a Kirjasto: alaholvi
BANK OF FINLAND BUL
Bank of Finland Bulletin : Special issue 1988 : foreign
Bank of Finland. Bulletin. Special issue 1988

Special Issue 1988
Foreign Trade

Finland's Trade Policy and Trade Policy Agreements by Veli Sundbäck	3
Trends in Finnish Current Account in the 1980s by Tapio Peura	10
Foreign Trade in the Finnish Economy by Pentti Forsman and Tapio Peura	16
Structural Developments in Foreign Trade by Pentti Forsman	22
Finland's Foreign Trade in Services by Jorma Hilpinen and Pirkko Miikkulainen	28
Finland's Trade and Economic Cooperation with the CMEA Countries by Terhi Kivilahti	34
Finland's Commercial Relations with Developing Countries by Alec Aalto	41
High Technology in Finnish Foreign Trade by Harri Luukkanen	48
European Integration and Finland by Veli Sundbäck	52

Apart from the articles by Hilpinen and Miikkulainen and Aalto, all these articles have previously appeared in various issues of the Bulletin in 1988.

PUBLISHER

Suomen Pankki Finlands Bank
P.O. Box 160, SF-00101 HELSINKI, FINLAND
Telephone: National (90) 1831
International +358 0 1831

Editor-in-Chief Antero Arimo
Editor Marja Hirvensalo-Niini
Subscriptions Heli Virtanen

Telex: 121224 SPFB SF
Telefax: 174872
Cables: SUOMENPANKKI

The contents of the Bulletin may be freely quoted,
but due acknowledgement is requested.

ISSN 0784-6509 ISBN 951-686-176-8

FINLAND'S TRADE POLICY AND TRADE POLICY AGREEMENTS

by **Veli Sundbäck**, Deputy Director-General
External Economic Relations
Ministry for Foreign Affairs

It is quite natural that under normal conditions a small market economy should opt for an open trade policy which aims at the liberalization of trade. Securing well-balanced social development and sustained economic growth and improving the nation's standard of living require imports of raw materials, intermediate goods and consumer goods on a large scale. Similarly, a small country must be able to ensure that its goods benefit from equitable competitive conditions in export markets in order to maintain and expand profitable production at home.

LIBERAL TRADE POLICY

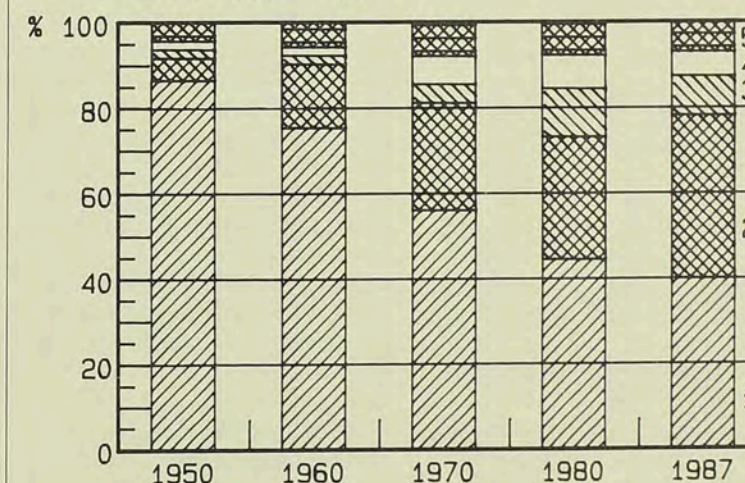
Accordingly, since the second world war Finland has consistently pursued a trade policy which seeks to establish and expand trade relations and remove obstacles to economic interaction on as wide a basis as possible. At the same time, Finland has participated in improving and simplifying the rules governing world trade. Although the specific content of the measures taken has varied and their timing been dependent on the changing economic environment, the basic orientation of trade policy has remained unchanged in Finland.

The experiences gained have been positive. Open trade policy has enabled Finland to consolidate its position abroad and to develop its relations with other countries in a way which has also supported Finland's policy of neutrality. Moreover, the competitiveness of Finnish companies in international

markets has been safeguarded. Foreign trade has developed favourably, the economy become stronger, the production structure diversified and the standard of living risen. In a few decades, Finland has come to rank amongst the world's richest nations measured in terms of national income. In 1986, Finland's per capita GDP was USD 14 350, placing Finland ninth amongst the OECD countries after Switzerland, the USA, the Federal Republic of Germany, Japan and the other Nordic countries but before e.g. France, Italy, the UK, Austria and Belgium.

The gradual liberalization of foreign trade has led to a deep-going and relatively rapid restructuring of the Finnish economy. At the end of the second world war, the Finnish economy still displayed many features characteristic of a developing country. Almost half of the population earned its livelihood from agriculture and forestry. In the other Nordic countries the corresponding figure was only 20 to 25 per cent. Today, the farming population accounts for no more than 8 to 9 per cent of Finland's total population of five million. In 1950, the forest industry dominated Finnish ex-

CHART 1.
COMPOSITION OF FINNISH MERCHANDISE EXPORTS BY INDUSTRY, PERCENTAGES, SELECTED YEARS 1950 — 1987



1. Forest industries
2. Metal and engineering industry
3. Chemical industry
4. Textile and clothing industry
5. Other industries

ports with a share of almost 80 per cent, while the share of metal and engineering industry products was only some 5 per cent. In 1987, their respective shares were roughly equal, both accounting for almost 40 per cent (Chart 1).

From the point of view of the economy, diversification of the industrial base has been necessary to secure and improve Finland's competitive position in international markets. Clearly, however, such rapid and drastic structural change cannot take place without problems. Companies, even entire industries, which have lost their competitive edge have encountered difficulties. This is the price an open economy has to pay for participating in the international division of labour. The sacrifices for the employees and owners of companies which have to close down may be very heavy indeed, particularly at times of high unemployment.

In such circumstances, protectionism may seem like an attractive option. Protectionist measures may even be justified in providing temporary relief for areas and branches in trouble until the necessary adjustment has taken place. In Finland, customs duties are high only in a very few sensitive branches, mainly in the textile and clothing industry. Import protection of key agricultural products has been kept high in order to secure a high level of self-sufficiency. Curtailing imports has necessitated special measures, such as import deposits in the early 1970s when balance of payments problems were most severe. But, apart from a few exceptions, Finland has not resorted to protecting its industry with trade barriers. Compared internationally, Finland has a good record as far as protectionism is concerned. Liberal trade policy has been possible in Finland because of the wide support it has enjoyed in all circles, including the trade unions.

Besides undergoing a radical restructuring, Finland's economy has become increasingly dependent on foreign trade. Export earnings account for some 30 per cent of GDP. More than half of the output of Finnish industry goes to exports, while two-thirds of Finland's energy requirements are imported. Raw materials, intermediate goods and investment goods make up some 80 per cent of Finland's total imports. Finland accounts for 0.7 per cent of world trade while Finns make up only 0.1 per cent of the total world population.

THE DEVELOPMENT OF THE TRADE AGREEMENT NETWORK

The main features of the development of Finland's network of trade agreements from the 1940s onwards closely follow the general trends in post-war trade policy. This is only natural — Finland cannot exert a particularly strong influence internationally, and thus has had instead to adjust to developments in trade policy in the world at large.

In the stringent conditions of the post-war period, trade policy was characterized both in Finland and abroad by strict regulation of foreign trade. The volume of exports and imports was determined by bilateral trade agreements and annual protocols on the exchange of goods. They were designed to maintain trade in full balance or at least to achieve as good a balance as possible. Payments were effected through clearing accounts held with central banks.

Membership of the IMF and GATT

However, the system applied in the years of reconstruction was rigid and inappropriate from the economic point of view. Fairly soon after the war international trade was put on a more flexible footing by the introduction of new rules and the

gradual liberalization of trade. The International Monetary Fund (IMF) was set up in 1945 to maintain the stability of the major international trading currencies and to promote their convertibility. Finland joined the IMF in 1948.

Finland signed the General Agreement on Tariffs and Trade (GATT) in 1950 and has since taken an active part in the GATT negotiation rounds. These decisions meant that Finland became a part of the system of open multilateral world trade by the beginning of the 1950s.

Trade agreements with the Soviet Union

A strong impetus to the development of Finnish foreign trade came from the war reparations to the Soviet Union. They also provided a basis for its diversification. Two-thirds of the reparations had to be paid in metal and engineering industry products, ships and machinery, which had not previously been manufactured in Finland in sufficient quantities to satisfy even domestic demand. Finland was forced to double its production capacity of these products in a fairly short time so as to be able to complete the payment of reparations by 1952.

An important development as regards trade policy was the conclusion of a trade agreement between Finland and the Soviet Union in 1947, which included the most-favoured-nation clause. In 1950, before the completion of the payment of reparations, Finland and the Soviet Union introduced the arrangement of five-year framework agreements, the first of which was for the years 1951–1955.

Since that time the Soviet Union has been an important trading partner for Finland, its share in Finland's total trade (15 to 25 per cent) being larger than its respective share in the trade of any other western industrial country. The trading system based on clearing ac-

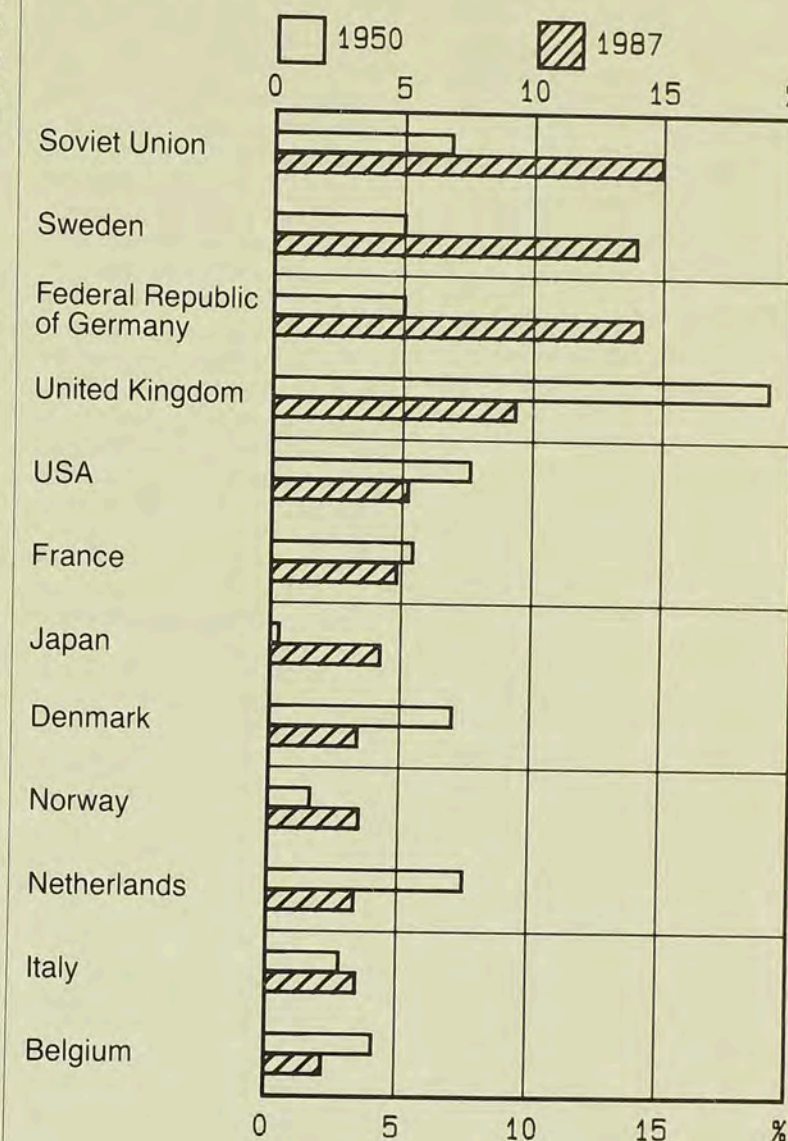
counts, framework agreements and annual protocols on the exchange of goods has been improved and expanded over the years. The arrangement guarantees a stable basis for Finnish-Soviet trade and has proved useful in evening out cyclical fluctuations in western trade.

Liberalization, the Helsinki Club protocol

Finland rejected Marshall aid for political reasons and consequently remained outside the Organization for European Economic Cooperation (OEEC) set up by the recipient countries and the European Payments Union connected with it. It was within these organizations that in the mid-1950s Finland's Western European trading partners agreed on the liberalization of their trade by means of the free list treatment and on the convertibility of their currencies. The OEEC countries included Finland's most important trading partners (Chart 2). Finland had to safeguard the markets for its exports of industrial products, primarily those of the wood-processing industry but also those of the metal and engineering industry. This required a gradual shift in Finnish trade policy from trade conducted on rigid bilateral lines towards multilateral trade, particularly as new regional market arrangements were being planned in Europe.

As Finland did not belong to the OEEC nor to the European Payments Union, a separate arrangement was decided on in the form of the Helsinki Club protocol. It was signed between Finland and 11 OEEC countries in 1957. It was agreed, initially only for 6 months, that Finland would open global quotas, within which importers would be allowed to use their quota share for purchases from any country that was a signatory to the agreement. In return, the OEEC countries which signed

CHART 2.
FINLAND'S MAJOR TRADING PARTNERS IN 1950 AND 1987,
PERCENTAGE SHARES



the Helsinki protocol agreed to treat Finnish exports in accordance with their current free lists. The agreement also included stipulations on the transfer of currency claims between countries. After a major devaluation in the autumn of 1957, Finland took the initiative of totally freeing from licencing the major part (some 3/4) of its imports from Western Europe.

These decisions marked a major step away from the regulation of foreign trade to-

wards an open economy and free trade.

Finnefta agreement

At around this time, regional integration had gained new momentum in European trade policy. The Six — the Federal Republic of Germany, Italy, France, Belgium, the Netherlands and Luxembourg — founded the European Economic Community (EEC) and Euratom in 1957 alongside the European Coal and Steel

Community established in 1951, while the more widely-based Western European free trade project (the Maudling round) planned within the OEEC was dropped. The OEEC countries which remained outside the EEC responded by founding their own free trade association EFTA. Negotiations were held on a customs union within the Nordic countries but did not lead to any agreement. Finland took part in these Nordic negotiations.

Finland did not participate in the negotiations on the foundation of EFTA and did not join the founder members of the organization.

However, as the founder members of EFTA included Finland's Nordic neighbours and the UK, which at the time was Finland's main trading partner accounting for some 24 per cent of Finland's total exports in 1960, it was vitally important for Finland to participate in the free trade between the EFTA countries so as to secure its competitive position. This led to the signing of the Finnefta agreement in 1961, a separate agreement between Finland and the EFTA countries. The agreement provided Finland with essentially the same rights and obligations as the other EFTA countries with the exception that Finland retained the right to maintain licencing of fuels and fertilizers; this exception was retained after Finland became a full member. Participation in EFTA has had a decisive impact on the opening up and development of Finnish foreign trade. It is also important that through EFTA, which does not have supranational decision-making powers, Finland has been able to take part in European economic cooperation in a way that is in accordance with its policy of neutrality.

Under a tariff agreement concluded in 1961, Finland granted the Soviet Union the

same tariff treatment as the EFTA countries.

The EFTA arrangements also meant free trade between the Nordic countries. In fact, the Nordic countries' own plans for a customs union had not been implemented because of the more extensive Western European agreements. Very close Nordic cooperation had evolved within the Nordic Council, which Finland joined in 1955. Its major achievements besides economic cooperation include a common labour market and the Nordic passport union. The Nordic countries account for about one-fifth of Finland's total trade, and the goal of making the Nordic area into a genuine domestic market is important to Finland.

Free trade agreement with the EEC

The first enlargement of the EEC in the early 1970s altered the existing trade policy set-up to such an extent that Finland had to react to it in order to protect its own interests. Finland now had to face the challenge of an even wider free trade area. However, developments in the 1960s had provided it with some readiness to take up the challenge: free trade with the other EFTA countries had been achieved in 1968; Finland had also taken active part in the GATT tariff reduction rounds and joined the OECD in 1969; Finland's foreign trade had become increasingly liberal, and the Finnish economy had diversified and strengthened.

The positive experiences of free trade in EFTA facilitated Finland's decision to sign a free trade agreement in 1973 with the EEC, which had expanded from six members to nine (now including the UK, Denmark and Ireland). Finland's agreement with the EEC has proved a success and Finnish trade with the Community has developed in a balanced way. When the other countries which had remained within EFTA concluded

similar free trade agreements with the EEC, the resulting network of agreements meant the emergence of a wide Western European free trade area. With the entry of Greece and Spain, it expanded to comprise a total of 18 countries and a market of some 350 million people. Thus the network of agreements of the EFTA countries and the European Community (EC) created essentially the same kind of free trade area as had been discussed in the Maudling round. The difference lay in the structure of the agreements.

Trade liberalization agreements with European socialist countries

Coinciding with Finland's agreement with the EEC in the early 1970s, Finland concluded a cooperation agreement with the Council for Mutual Economic Assistance (CMEA) and trade liberalization agreements with most of the European socialist countries.

The agreements with Hungary, the German Democratic Republic, Czechoslovakia, Bulgaria and Poland grant these countries similar free trade treatment to that in the trade with the EEC. They differ from Finland's EEC agreement in that those CMEA countries which do not have effective customs tariffs are committed to take internal measures to provide Finland with reciprocal trade concessions in their own markets. The experiences gained from the implementation of reciprocity vary from country to country. The system of agreements between Finland and the Soviet Union was extended in 1955 by an agreement on scientific and technical cooperation and in 1967 by the setting up of an economic commission and the introduction of a long-term programme for economic cooperation.

At the multilateral level Finland seeks to develop east-west economic cooperation

both within the Economic Commission for Europe (ECE) of the United Nations and the Conference on Security and Cooperation in Europe (CSCE). Since 1955, Finland has taken an active part in the extensive activities of the ECE, which focus on the development of trade and transport, energy and environmental issues. As host to the Helsinki conference in 1975, cooperation within the CSCE is of particular importance to Finland in respect of economic issues as well.

GSP treatment for developing countries

As regards trade with developing countries Finland has been involved in approving the generalized system of preferences (GSP) through its participation in GATT and UNCTAD and in supporting efforts to integrate developing countries more closely into the world trading system. As early as 1972 Finland granted GSP treatment to over one hundred developing countries, which meant duty free import of developing country products to Finland without any quantitative limits. Only some sensitive products have been excluded from GSP treatment. During the past few decades, Finland has also sought to expand trade and economic cooperation with developing countries by entering into bilateral agreements on economic, industrial and technical cooperation with 24 developing countries.

Membership of EFTA

Finland became a full member of EFTA in early 1986 and thus formally established the situation which had prevailed in effect for a long time. Finland's accession coincided with Portugal's departure from EFTA to join the EC. As a full member of EFTA Finland has full power to influence the decisions of the free trade association. Together with other Nordic countries and neutral EFTA members (Iceland, Norway,

Sweden, Austria and Switzerland) Finland seeks to strengthen EFTA's position and enhance its activities in response to new challenges, one of the most important of which is cooperation with the EC for the development of a free trade system in Western Europe. EFTA also plays a balancing role in wider European cooperation and EFTA countries contribute actively to the GATT negotiations.

Imports largely duty free

The trade agreement network created in the post-war period means that industrial products are imported duty free from EFTA and EC countries, the Soviet Union, the German Democratic Republic, Czechoslovakia, Bulgaria, Poland, Hungary and the developing countries receiving GSP treatment. Duty free imports account for about 87 per cent of Finland's total imports. It should also be noted that the general level of duty is very low as a result of several GATT rounds; the average incidence of duty amounting to only 7.6 per cent for that part subject to duty.

TECHNOLOGICAL COOPERATION

Finland takes part in international technological cooperation in many ways. Technological cooperation with the USSR has been going on for over 30 years and a framework agreement on space cooperation has been concluded.

Finland has increased its participation in Western Europe's increasingly intensive cooperation in science and technology. Finland has participated in Eureka from the very beginning, and Finnish companies and research institutions are now involved in some twenty Eureka projects. An agreement of association with ESA and a framework agreement on research and development with the EC have been concluded. Finland is

seeking participation in some of the central research programmes of the EC, and also has a framework agreement with the USA in this field.

CURRENT CHALLENGES TO TRADE POLICY

Finland's existing trade agreement network is so comprehensive that no radical changes are expected in it in the near future. However, adjustment to the increasingly rapid development of international trade and economic cooperation requires continuous adjustment in the trade policy mechanism. Although the basic policy stance adopted by Finland several decades ago will remain unchanged, the constantly changing environment may require new kinds of practical measures in its application. Current issues which require special attention in Finnish trade policy include the development of the international trading system, integration in Western Europe and the economic reform in the Soviet Union.

GATT, Uruguay Round

A new round of negotiations on the development of the international trading system, the Uruguay Round, started within GATT just over a year ago. In the present uncertain times, their importance as an antiprotectionist force is particularly underlined. Finland seeks — through active participation within the joint Nordic negotiating group — to secure a successful continuation of the negotiations. The strengthening of the GATT system and complementing and developing the rules governing world trade are important aims in Finnish trade policy. A clear set of rules on multilateral trade is of particular importance to small countries with limited negotiating powers.

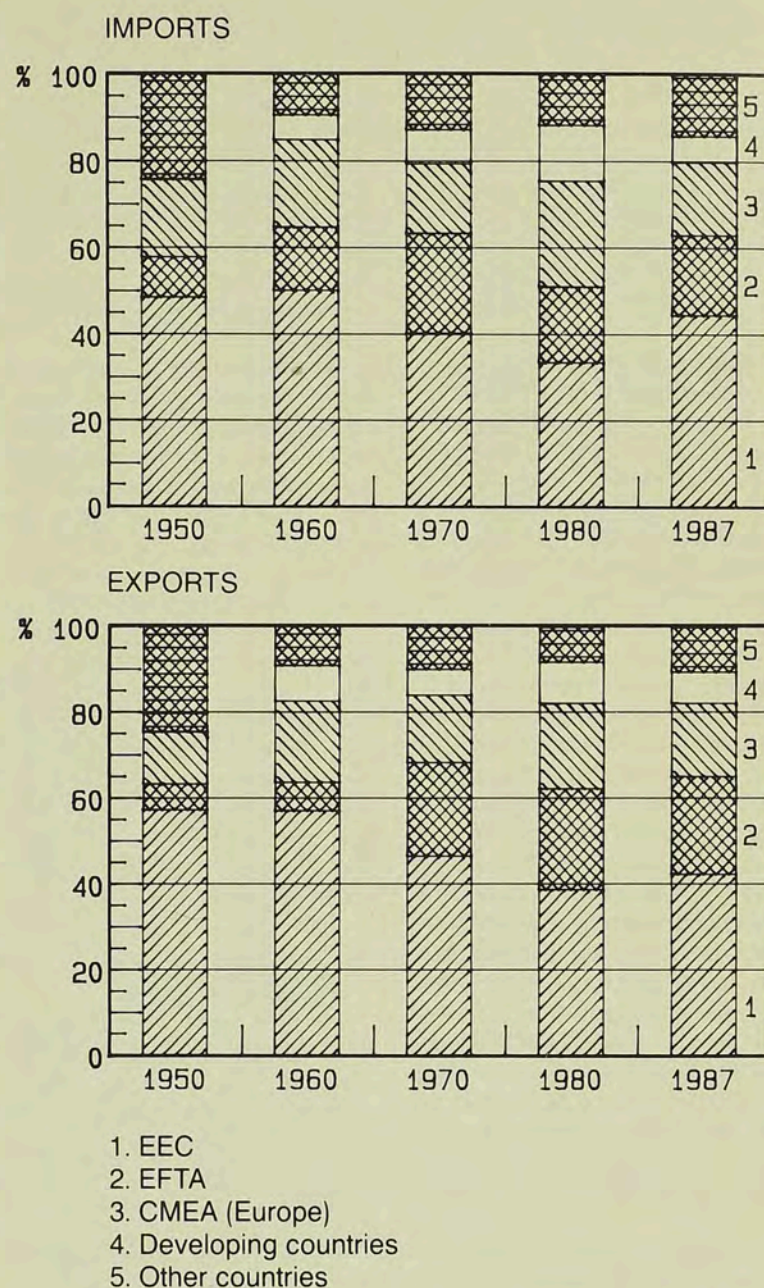
The GATT negotiations also mean new challenges to Finland, the most important

probably being the pressures for liberalization of trade in agricultural produce. Maintaining a high level of self-sufficiency in agriculture is important to Finland for a number of reasons. Hence efficient import protection will be necessary in the future too, at least in the case of basic agricultural produce. Finland has, nevertheless, to be prepared to significantly reduce the scale of its subsidized exports of agricultural produce.

Western European integration

About two-thirds of Finland's total exports go to Western European markets, and the share seems to be growing. Consequently developments in trade policy in this area are of crucial importance to Finland. The EC's aim of creating a genuine internal market within the Community by 1992 is positive from the point of view of Finnish exports. Finland must nevertheless ensure that the relative competitive position attained through the free trade arrangements will be maintained. This requires that the remaining trade barriers be removed at the same pace in Finland's trade with the EC as they are removed inside the Community. Finland is seeking to achieve this jointly with the other EFTA countries. A wide-ranging negotiation process has been initiated between the EFTA countries and the EC with the aim of creating the European Economic Space (EES). It involves developing the world's most extensive free trade area — with some 350 million consumers — towards an increasingly integrated market. This area accounts for about one-quarter of the world's total trade. As an EFTA member Finland strives to actively contribute to the success of these negotiations and to the removal of such trade obstacles as technical trade barriers, trade distorting government subsidies to industry, administrative trade hin-

CHART 3.
REGIONAL COMPOSITION OF FINLAND'S FOREIGN TRADE, PERCENTAGES, SELECTED YEARS 1950 — 1987¹



¹The country composition of regions used throughout is that of 1987

drances and many other factors impeding economic interaction.

Economic reform in the Soviet Union

The Soviet Union, which accounts for about one fifth of

Finnish foreign trade, is currently carrying out a far-reaching programme of economic reform and development. The changes in the Soviet Union's foreign trade system will inevitably be reflected in Finland, bringing both new oppor-

tunities and new challenges. It is essential for Finland to monitor this process and to make full use of the potential it offers for the development of trade and economic cooperation.

Global liberalization

The key region for Finland's foreign trade has been and continues to be Europe, which accounts for some 80 per cent of Finland's total foreign trade. Finland's free trade agreements are also with this region.

Finland's Nordic neighbours and the Soviet Union each account for some 15—20 per cent of Finland's trade. It is a basic premiss of Finland's trade policy that regionally limited cooperation does not exclude development of cooperation on a wider basis. The liberalization of regional trade contributes to the liberalization of world trade and has a trade-creating effect. Indeed, the aim of Finland's policy is the development of trade and economic relations in all directions.

The vital importance of foreign trade to the Finnish economy and the predominantly positive experiences gained from the liberalization of trade give strong support for continuing to pursue trade policy along the lines followed hitherto.

February 15, 1988

TRENDS IN THE FINNISH CURRENT ACCOUNT IN THE 1980s

by **Tapio Peura**, Acting Head of Office
Economics Department
Bank of Finland

INTRODUCTION

Finland's economic performance has been fairly good in the current decade. Economic growth has been steady and, at an annual average rate of 3.3 per cent, one percentage point faster than in the OECD countries as a whole. Despite faster growth, both the internal and external balance of the economy have improved as compared to approximately the 1970s. Since the beginning of the 1980s, Finland's unemployment rate has remained at around 5 per cent, which is notably lower than in the OECD area on average. Reflecting the faster growth rate, inflation has been somewhat higher than in competitor countries. However, the inflation differential has narrowed in the past few years, and in the latter half of 1987 the 12-month rise in consumer prices in Finland was running at approximately the average rate for the OECD area.

Significant improvement has also taken place in the external balance. Although the current account has remained in deficit in the 1980s, the annual deficits have been modest — about 1.5 per cent of GDP on average — compared with those recorded in the 1960s and 1970s. The maintenance of external balance has not been a cause for concern in economic policy in the 1980s to the extent that it was in the previous two decades.

Developments in the current account during the past two years or so nevertheless indicate that the external constraint will have to be taken into account in economic policy in

the near future. In 1987, the current account deficit doubled from the previous year to FIM 9.2 billion, equivalent to 2.4 per cent of GDP. For current account figures, see Table 6 in the statistics-section).

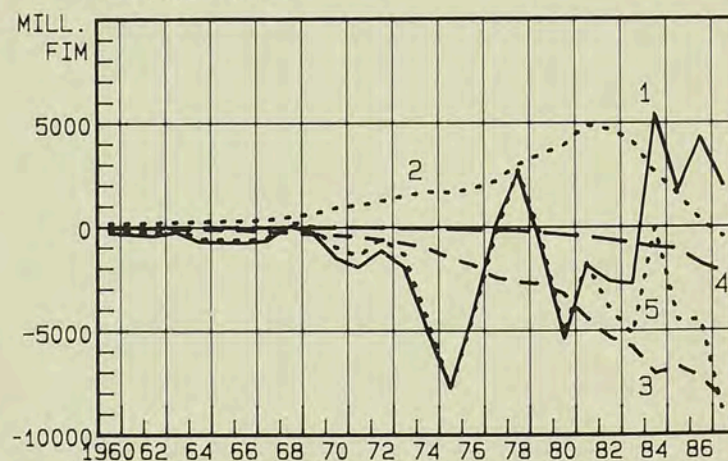
General trends in the current account

Merchandise trade accounts for approximately 75 per cent of Finland's transactions on current account, trade in services for about 15 per cent and factor income and unrequited transfers abroad for the remainder. The 1980s have witnessed major changes in the balances of these components of the current account, which clearly deviate from the trends observed in the 1960s and 1970s (Chart 1).

In the two decades up to the beginning of the 1980s, the current account balance was roughly the same as the balance on merchandise trade. A growing surplus on the services account offset a widening deficit on the net investment income account. The transfers account was of little significance for the overall external balance.

In the 1980s, developments in the current account and the trade account have deviated from each other. The merchandise trade account has moved into surplus while the current account has shown a slight deficit, and in recent years the deficit has been increasing. This has partly been due to the fact that the traditional surplus on services has shrunk —

CHART 1.
MAIN CURRENT ACCOUNT COMPONENTS
IN 1960 - 1987



1. Trade account
2. Services account
3. Factor income
4. Unrequited transfers
5. Current account

actually turning into a slight deficit in 1987 — and partly to the fact that the deficits on the investment income and transfers accounts have deepened. The present weakening of the current account is thus not so much connected with merchandise trade as with the invisible items.

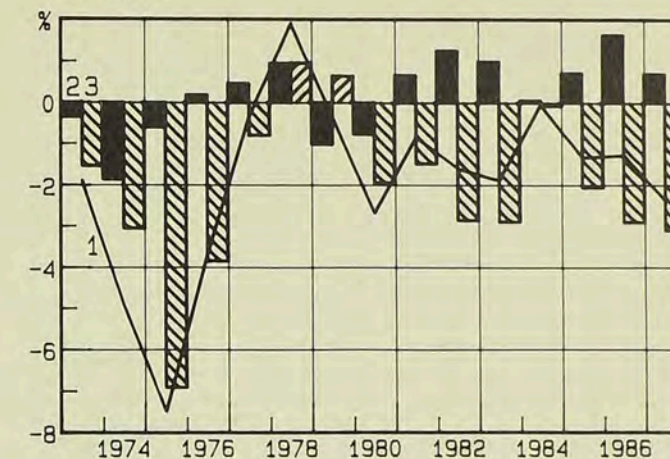
The explanation for the change in general trends in the current account is to be found in the economic policies pursued. Since the latter part of the 1970s, the central aim of economic policy has been to improve and secure the price and real competitiveness of the open sector of the economy. The growth of industrial production has in fact been faster in Finland than in most other countries, and the balance on merchandise trade has improved markedly.

On the other hand, the rapid growth of real incomes in Finland has meant that Finns have purchased foreign services to an increasing extent. Moreover, the relatively rapid rise in earnings in industry has spread to the service sector, where productivity developments have not been as favourable. Accordingly, costs in the service sector have increased faster and the competitiveness of the service sector has deteriorated. Along with the rapid rise in real incomes, this has been a major factor behind the deterioration of the services account.

The role of bilateral trade

In recent years, roughly one-fifth of Finland's foreign trade has been conducted within the framework of bilateral trade in tied currencies. This trade is almost entirely made up of Finland's trade with the Soviet Union. Mainly because of fluctuations in the world market price of crude oil imbalances have arisen in current account transactions in tied currencies. Normally, such surpluses and deficits are balanced within the duration of 5-year framework

CHART 2.
CURRENT ACCOUNT IN 1973 - 1987, PER CENT
OF GDP



1. Total current account
2. In tied currencies
3. In convertible currencies

agreements between Finland and the Soviet Union. Thus, the effect on the external balance can be assumed to be neutral in the medium term (Chart 2).

However, the surplus in Finland's favour that has been generated in bilateral trade with the Soviet Union in recent years has been reduced, inter alia, by purchases of oil for resale to third countries. These transactions are recorded in the capital account, not in the current account: purchases from the Soviet Union result in a reduction in Finland's rouble receivables while sales to third countries augment the convertible reserves by a similar amount. This means that the recent surpluses in the current account in tied currencies will not be matched by deficits of comparable size in the future.

MERCHANDISE TRADE

The balance on Finland's western trade has been improving ever since the mid-1970s, and has been in surplus since 1984. Among the factors con-

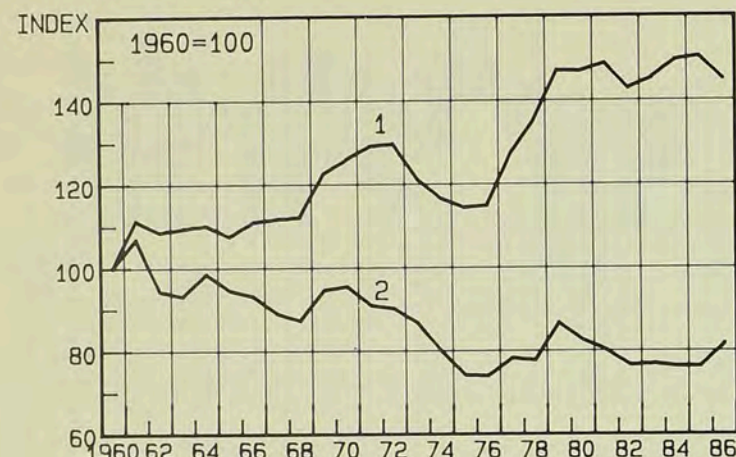
tributing to the surplus have been favourable developments in the volume of western exports, a decline in oil imports from western countries as well as improved terms of trade. Thanks to good export performance, the surplus amounted to FIM 8.7 billion in 1984. Subsequently, the surplus has shrunk but still amounted to FIM 1.7 billion in 1987. The volume of imports from western countries has been growing at a faster rate than exports in recent years.

Exports

In the 1980s, developments in Finland's western exports have mirrored the growth of Finland's western export markets. From 1980 to 1987, both the volume of western exports and export markets grew by an average of 3.3 per cent per year. In broad terms, market shares were thus maintained unchanged.

According to constant-market-share analysis, which distinguishes between the effects of regional and commodity patterns on export performance, both the regional and commodity structure of exports

CHART 3.
EXPORT PERFORMANCE IN WESTERN MARKETS
IN 1960 - 1986



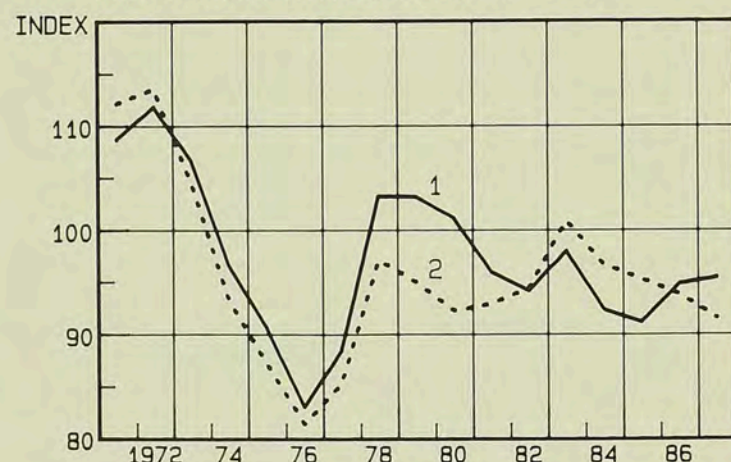
1. Growth of Finnish exports less growth of structurally adjusted demand
2. Growth of Finnish exports less growth of total demand

have supported the rapid growth of exports in recent years. These factors had a negative impact on Finnish export performance in western markets in the 1970s. Viewed regionally, the growth of exports has focussed on countries of the European Community, while paper and metal industry products have been the fastest growing commodity groups. Constant-market-share calculations indicate that the effect of competitiveness has been more or less neutral in the 1980s (Chart 3).

Major changes in exchange rates have altered competitive positions in different market areas. Measured in terms of relative unit labour costs, Finland's price competitiveness has weakened since 1983, when calculated with world market share weights. In 1986-87, the deterioration was entirely due to changes in exchange rates. However, price competitiveness has improved in European markets as a result of the weakening of the Finnish markka in relation to EMS currencies (Chart 4). Moreover, the competitiveness of Finnish exports has been enhanced by

tax measures that have reduced costs other than labour costs in manufacturing.

CHART 4.
PRICE COMPETITIVENESS IN 1971 - 1987



Relative unit labour costs in manufacturing,
14 competitor countries/Finland, in common currency,
index 1964 - 1982 = 100

1. European market-share weights
2. World trade market-share weights

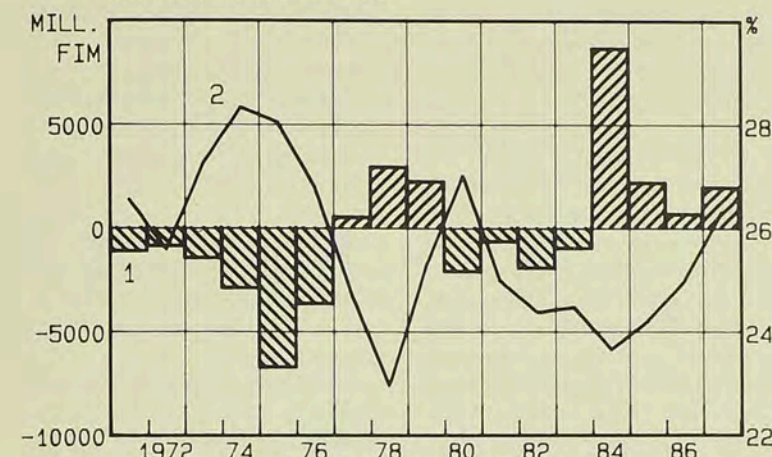
Curve rises: Finland's competitiveness improves
Curve falls: Finland's competitiveness deteriorates

Imports

In the first half of the 1980s, the growth of total domestic demand was relatively slow, so that the increase in imports was also rather modest. The growth of imports was curbed in particular by a reduction in raw material stocks and the modest growth of investment in machinery and equipment. The ratio of imports to GDP declined for several years (Chart 5).

Import growth started to recover along with the growth of industrial investment in 1985. Household incomes increased rapidly as a result of expansionary fiscal policies and improved terms of trade, and the growth rate of private consumption accelerated to 4 per cent in 1986 and to 5 per cent in 1987. The increase in imports was also boosted by the growth of stocks and investment in machinery and equipment in the corporate sector. In fact, the rate of growth of merchandise

CHART 5.
WESTERN TRADE BALANCE AND PROPENSITY TO
IMPORT IN 1971 - 1987



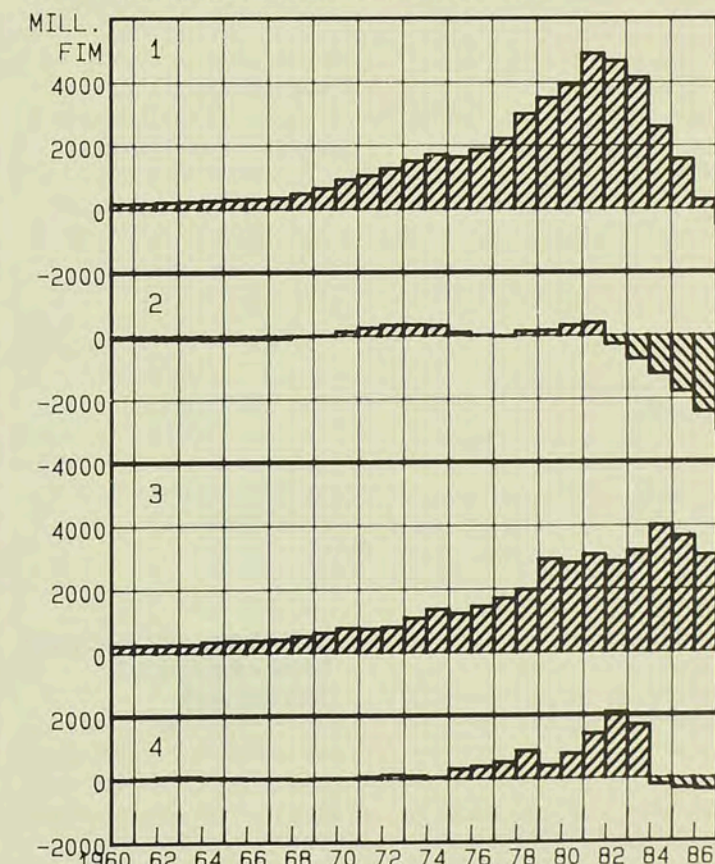
1. The balance of western trade, mill. FIM (left scale)
2. Imports of goods as a percentage of GDP (right scale)

imports was double that of GDP in 1985-1987, and the ratio of imports to GDP climbed back to the levels of the 1970s. There were marked increases in import propensity as regards both raw material imports and imports of consumer goods.

A clear upward trend has become evident in imports of consumer goods, which have been increasing faster than private consumption. The growth of imports has been strong in all main categories, including food, clothing and cars. Households have apparently concluded that their real incomes have grown permanently and have changed their consumption habits accordingly. This development has also been supported by the improved availability of credit resulting from deregulation of financial markets.

Another reason for the rapid growth of imports would seem to be the weakening of the price competitiveness of industries competing with imported commodities. High labour costs in Finland have also led to the transfer of labour-intensive production to countries where costs are lower.

CHART 6.
SERVICES ACCOUNT IN 1960 - 1987



1. Total balance
2. Travel balance
3. Transportation balance
4. Other services balance

TRADE IN SERVICES

Trade in services has traditionally shown a surplus in Finland's favour. The annual surplus increased up till the early 1980s, whereafter it started to shrink. In 1987, the services account turned into a small deficit.

Finland's trade in services is fairly evenly distributed between travel, transportation and other services. The weakening of the services account reflects a turnaround that has taken place in each of the main items, though the reasons for the deterioration differ to some extent in each case (Chart 6).

The travel account

Finland's travel account was in surplus for most of the 1970s.

In the current decade, travel expenditure has increased faster than earlier, whereas the growth of travel receipts has slowed down considerably. The travel account moved into deficit in 1982, and the deficit has deepened continuously since then. In 1987, the deficit amounted to FIM 3 billion (Chart 6).

The key factors influencing the travel account in the 1980s have been unfavourable from Finland's point of view. Reflecting a rapidly rising standard of living, private consumption in Finland has increased on average by more than one percentage point a year faster than in the countries which are important sources of travel receipts for Finland, while an increasing share of consumption expenditure has gone on foreign travel. At the same time, inflation in Finland has been faster, and the price competitiveness of services related to travel has weakened.

Normally, nearly one-half of receipts from tourism are in Swedish kronor, and hence the weakening on the revenue side of the account is partly due to the depreciation of the Swedish krona vis-à-vis the Finnish markka in the 1980s.

The transportation account

As Finland's merchandise imports are recorded on a c.i.f. basis, part of transport expenditure is included in the trade account. The transportation account showed a growing surplus up till the mid-1980s, but in recent years the surplus has been diminishing mainly because of declining transport receipts. The major part of transport revenue is derived from shipping.

The number and tonnage of merchant ships sailing under the Finnish flag has contracted sharply in the 1980s. Vessels have been sold abroad and transferred to flags of convenience. The main factors behind the reduction in the merchant fleet are high labour

costs and excess world capacity, which have depressed freight rates and weakened the profitability of shipping. The difficulties in shipping are clearly reflected in the transport account (Chart 6).

Other services

Developments in the price of oil have had a major impact on trade in other services. Following the oil price rises in the 1970s, Finnish construction companies received many orders for construction projects in the oil-producing countries of the Middle East as well as in the Soviet Union. Planning and engineering work connected with these projects gave rise to a rapid increase in receipts from other services, and the surplus on the other services account grew up till the early 1980s (Chart 6).

Subsequently, the Iran-Iraq war and a fall in Finnish oil imports from this region have decreased project exports to the Persian Gulf countries. Similarly, the surplus in Finland's trade with the USSR has reduced project exports to the Soviet Union. Thus, the balance on trade in other services turned into a deficit in 1984. In 1987, Finland received orders for several new construction projects in the Soviet Union, but the low oil price has curtailed the implementation of these projects as efforts have at the same time been made to balance trade partly by limiting exports.

INVESTMENT INCOME AND TRANSFER PAYMENTS

Financing the current account deficit by recourse to capital imports has led to increased interest payments abroad. In addition, higher interest rates in Finland than abroad have at times attracted inflows of short-term capital in excess of current account financing requirements. The reinvestment of these funds in the form of foreign exchange

reserves does not — given the special considerations attaching to reserves — normally yield as high returns as those paid out. In recent years, payments of interest and dividends to foreign investors on their portfolio and direct investments in Finland have also increased, while the corresponding receipts of Finnish investors have remained notably smaller. Last year, the deficit on the investment income account rose to FIM 8 billion.

The deterioration in the transfers account mainly reflects increased development assistance. Finland's official development aid has grown rapidly in recent years. In 1987, it rose to 0.55 per cent of GDP, and the aim is to increase it further. Insurance indemnities paid abroad by Finnish insurance companies also increased rapidly in the early 1980s, thus weakening the transfers account. In 1987, the deficit on the transfers account totalled FIM 2.1 billion.

FOREIGN INDEBTEDNESS

As Finland's current account has nearly always shown a slight deficit, net foreign debt has increased in nominal terms. During the past ten years, the annual rate of increase in net debt has, however, been lower than that of the growth of GDP, so that relative indebtedness has fallen.

The level of indebtedness peaked at the end of 1977, amounting to over 20 per cent of GDP. The rapid growth of foreign debt was the chief factor behind the changes implemented in the overall orientation of economic policy at that time. In the subsequent ten years, net foreign debt has declined in relative terms, and stood at 14.2 per cent of GDP at the end of 1987. The government sector accounts for half of the outstanding debt. Finland's foreign indebtedness is lower than that of the other Nordic countries.

Debt servicing costs have remained more or less unchanged during the past decade, amounting to about 3 1/2 per cent of GDP. The share of interest payments is about 2 percentage points, the remainder being attributable to repayments.

CONCLUDING REMARKS

Finland's external balance was relatively good in the first half of the current decade, but has deteriorated somewhat since then despite a favourable export performance in western markets.

The surplus on merchandise trade has declined from the peak reached a few years ago owing to the fact that import propensity has, after falling in the early 1980s, climbed back

to the average level prevailing in the 1970s. The pressure on the external balance stemming from the rise in import propensity should be waning by now, and hence the merchandise trade account should continue to show moderate surpluses in the future.

Trade in services was the main factor contributing to the weakening of the external balance in the first half of the 1980s. During the last two years, the deterioration of the services account has shown signs of levelling off. In the travel account, however, the deficit seems likely to deepen further; the share of travel in consumption expenditure is still relatively low in Finland.

The reduction in the size of the merchant marine has already brought about changes in rigid working time

and crew regulations, and the transfer of ships to flags of convenience has slowed down. Thus, the worsening of the transport account can be expected to come to a halt. In other services, the key source of income, construction projects abroad, is recovering.

As Finland's foreign debt in relation to GDP has remained stable at a moderate level, a modest current account deficit has not so far constituted a major concern for economic policy. A continuation of the present weaker trends might, however, make it difficult for Finland to maintain a higher level of economic activity than in other OECD countries.

February 26, 1988

FOREIGN TRADE IN THE FINNISH ECONOMY

by **Pentti Forsman**, M.Pol.Sc.,
and **Tapio Peura**, M.Sc. (Econ.)
Economics Department
Bank of Finland

THE ROLE OF FOREIGN TRADE IN THE ECONOMY

As is usual in small open economies, foreign trade has played an important role in Finland's economic development. The share of trade in goods and services in total demand and output in Finland is at the average level prevailing in Europe, which was nearly 30 per cent of GDP in the first half of the 1980s. The corresponding share is considerably higher in other Nordic countries, not to mention some smaller countries in continental Europe. The fact that the share of foreign trade is lower than in other small countries can partly be attributed to the minor importance of services in Finland's foreign trade and partly to Finland's natural resource base and peripheral location. For example, the forest industries, traditionally the largest export branch, uses predominantly domestic inputs. In the economically integrated and geographically centralized markets of continental Europe, a product may cross borders several times before it reaches the end user.

TABLE 1. EXPORTS OF GOODS AND SERVICES AS A PERCENTAGE OF GDP

	1960	1970	1980	1986
Finland	22.5	26.2	32.9	26.5
Sweden	22.9	24.1	29.8	33.1
Norway	41.3	41.8	47.3	37.6
OECD Europe	20.3	22.8	28.6	28.8

Virtually all of manufacturing output in Finland is heavily

TABLE 2. RATIO OF EXPORTS TO GROSS VALUE OF PRODUCTION, PER CENT

Industry	1964-66	1974-76	1984-86
Total manufacturing ¹	22.6	24.9	31.7
Forest industries	60.7	53.0	59.2
Metal and engineering industries	17.6	30.2	45.7
Textile and clothing industries	10.4	33.4	45.9

¹ Among other things, oil refining for domestic use lowers the figures for total manufacturing.

dependent on foreign trade. More than half the output of the forest industries is sold abroad, and in other branches, too, notably the metal and engineering industries and the textile and clothing industries, the growth of production has increasingly come to rely on foreign demand.

Participation in international trade has required specialization. For example, the share of the Finnish forest industries in total world trade in forest products is about 9 per cent and in some paper products Finland is the world's largest exporter. Although the relative shares of other major industries in total world trade in the products concerned are small, Finland does have significant world-market shares in certain specialized products. All in all, Finland's share in world trade only amounts to just under one per cent.

EXPORT-LED GROWTH

In the post-war period, one of the prime aims of economic policy has been to raise living standards by promoting economic growth. This has been achieved by creating industrial capacity that relies on expanding foreign trade. In fact, growth of industrial output

has been faster in Finland than in other European countries, and this has also contributed to faster growth of GDP.

Integration in Europe has resulted in a strong increase in intra-industry trade so that growth of exports has not been fully reflected in production. Consequently, the expansion of Finnish exports has been slower than the average in Europe. In contrast to many other countries, however, output growth has focussed on industrial activity in the exposed sectors of the economy. Between 1955 and 1985, Finnish exports of goods and services expanded at an average annual rate of 6.0 per cent. Over the same period, GDP growth averaged 3.9 per cent. Consumption increased by 4.0 per cent a year on average and investment by 3.5 per cent.

Thanks to the strategy of export-led growth, it has been possible to exploit economies of scale, particularly in the forest industries, and also to diversify production, for example, in the metal and engineering industries and the chemical industry.¹ Finland has not

¹For a review of structural developments in foreign trade, see the article by Pentti Forsman in the May 1988 issue of the Bulletin.

TABLE 3. OUTPUT AND EXPORTS IN FINLAND AND IN WESTERN EUROPE IN 1960-73 AND IN 1973-86, AVERAGE ANNUAL GROWTH IN PER CENT

	GDP	Industrial production	Volume of exports
1960-73			
Finland	3.9	4.9	5.4
OECD Europe	3.3	3.7	6.7
1973-86			
Finland	2.8	3.1	3.6
OECD Europe	2.1	1.2	4.1

resorted to direct subsidies or trade barriers in the face of abrupt changes in the international economy. Companies have been forced to adjust quickly to changes, thereby preventing the emergence of crisis industries. Foreign competition has also helped to keep pricing in the domestic market in check. These factors have contributed to efficient resource allocation, which partly explains Finland's higher growth rate in comparison to other European countries since the late 1970s.

Orientation towards international markets has demanded great adaptability on the part of

Finnish firms. In recent years, this has been evident in the rapid internationalization of business and industry as companies have sought to secure market shares. Direct investment abroad in relation to manufacturing investment at home increased from 3 per cent at the beginning of 1980s to 15 per cent in 1987.

In many industries a larger firm size has become essential for success in international competition. The forest industries, in particular, have undergone a major restructuring during the past few years. For the economy as a whole, direct investment abroad, togeth-

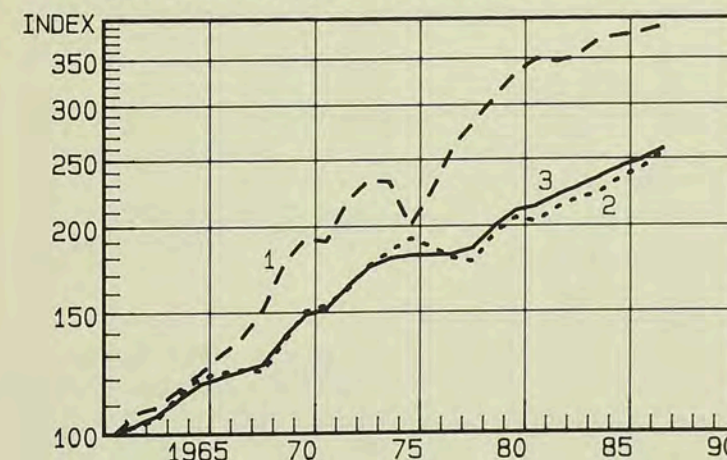
er with 'strategic' imports, make possible the introduction of new technologies and know-how. As a result of policies aimed at promoting growth by emphasizing foreign trade and a sufficient rate of investment, Finland now has an industrial base which for the most part is modern and efficient, although there is continuing need for the reallocation of resources.

DEPENDENCE ON INTERNATIONAL DEVELOPMENTS

Growth policies based largely on expanding foreign trade have also entailed increasing dependence on international developments. Thus income developments in the economy are strongly dependent on the demand for Finnish exports in world markets, on the one hand, and on the prices and availability of imports, on the other. Furthermore, the structure of Finnish exports has traditionally been such that international developments have been felt strongly in the Finnish economy.

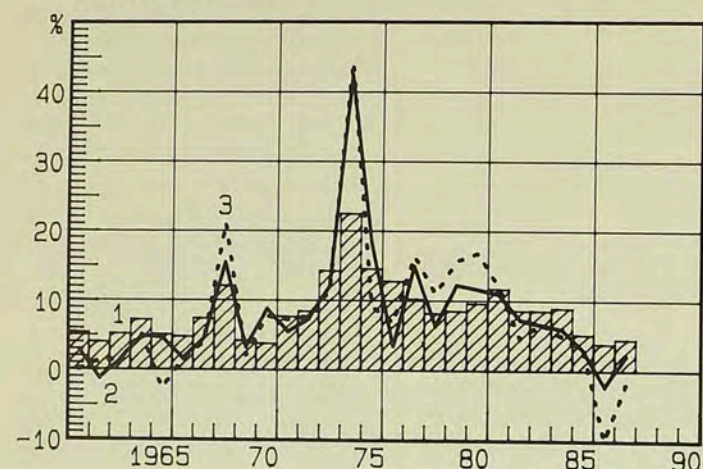
Cyclical variations and other shocks emanating from abroad are reflected in the Finnish economy mainly via foreign trade. A boom in the cyclically sensitive forest industries, as manifested in expanding export volumes and rising export prices, generates higher incomes in the economy. Typically, the cycle is rapidly transmitted to other sectors, resulting in excess demand and inflationary pressures. When export markets subsequently weaken, it proves difficult to curb domestic inflation and demand, leaving the economy with a higher rate of inflation than elsewhere. This has often led to external disequilibria. In the past, the cost differential that arose between the domestic economy and competitor countries was corrected by a change in the exchange rate. But, though devaluations had a beneficial impact on output, employment and the trade

CHART 1. DEVELOPMENTS IN EXPORTS, DOMESTIC DEMAND AND GDP, VOLUME, 1961 = 100



1. Exports
2. Total domestic demand
3. GDP

CHART 2.
FOREIGN TRADE PRICES AND DOMESTIC INFLATION



Annual percentage changes

1. GDP-deflator
2. Export unit value
3. Import unit value

balance, they also contained the seeds of a new acceleration of inflation. The term "devaluation cycle" was used to describe an observed period of approximately 10 years between major devaluations, typically spanning two "normal" business cycles.

This vicious circle reached a head in the mid-1970s. A sharp rise in export prices connected with the world commodity boom set in motion a rapid surge in wages and other domestic costs. This resulted in a substantial deficit on current account as exports faltered, partly because of a loss in competitiveness. Devaluations in 1977-78, coupled with a reorientation of economic policies, restored the external balance and, with the ensuing recovery of economic growth, gradually also the internal balance of the economy.

Thanks to the greater diversity of exports — particularly the declining share of less highly processed forest industry products — cyclical variations have diminished. Since, moreover, a

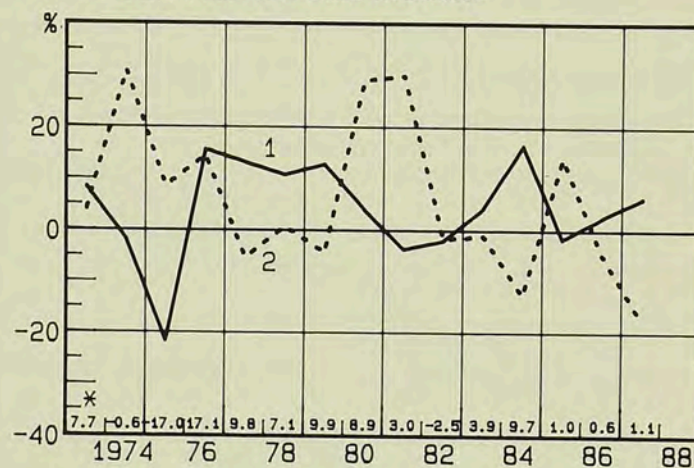
large proportion of industrial inputs are imported, devaluation is today only of limited effectiveness in correcting cost differentials. Indeed, in the 1980s, a period of volatile ex-

change rates internationally, Finland has consistently pursued a stable exchange rate policy.

Contributing to the comparatively rapid and balanced growth performance of the Finnish economy in the 1980s has been bilateral trade. The bilateral trade arrangements with the Soviet Union have helped to smoothen the cyclical fluctuations in western exports caused by the oil price rises. Approximately 80 per cent of Finland's imports from the Soviet Union consists of energy products, and Finland was able to pay for its increased import bill by increasing exports to the Soviet market. Consequently, the terms-of-trade losses have not had such an adverse influence on output and employment in Finland as in other European countries.

Hence, Finland's increased dependence on international markets has not been accompanied by an increase in vulnerability to external disturbances; rather, the opposite has been the case. Fluctuations in national income have diminished

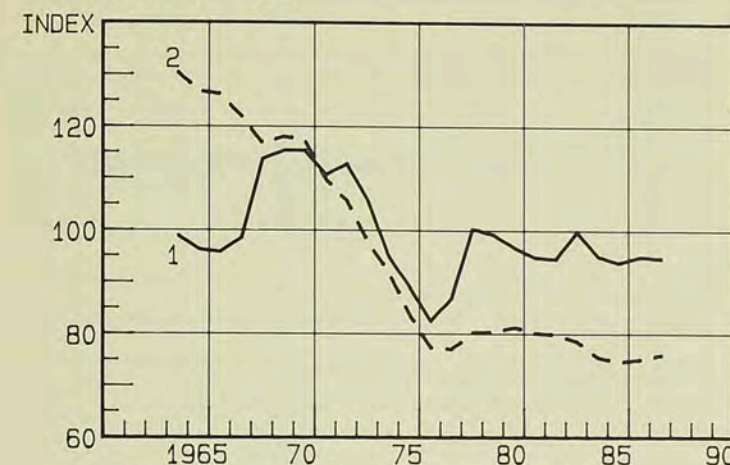
CHART 3.
WESTERN EXPORTS AND BILATERAL EXPORTS, PERCENTAGE VOLUME CHANGE



* Change in volume of total exports

1. Exports to western markets
2. Bilateral exports

CHART 4.
RELATIVE UNIT LABOUR COSTS IN MANUFACTURING, 14 COMPETITOR COUNTRIES/FINLAND, 1964 - 82 = 100



1. In common currency
2. In national currencies

ed owing to a more diversified production structure. The relatively rapid adjustment of output to changes in international business conditions and demand patterns has also had a favourable impact on income formation. Rising incomes and the constraints imposed by international price developments have also reduced disputes over income distribution; such dissension has been detrimental for balanced growth in many other countries. Of course, the slower rate of growth in the industrial countries has also been reflected in Finland, but the benefits obtained from increasing openness have nevertheless compensated for the adverse effects.

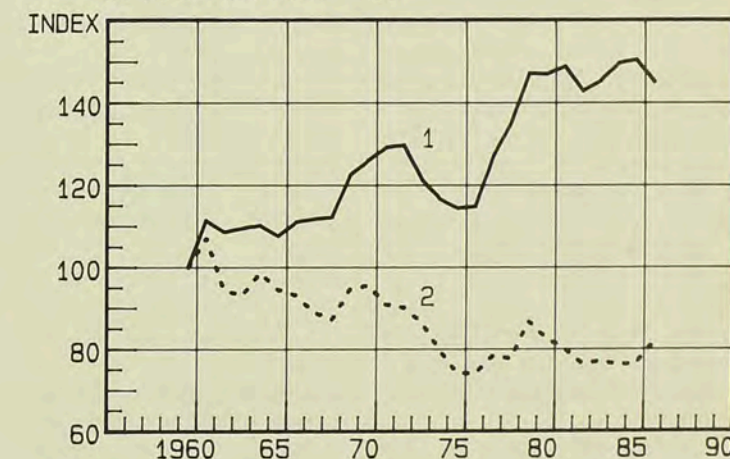
COMPETITIVENESS AND FOREIGN TRADE PERFORMANCE

The opening up of the economy to foreign competition has at times put Finland's external and internal balance under strain. Macroeconomic imbalances were common in the 1960s and 1970s, in par-

to exchange rate changes to restore cost competitiveness is counter-productive in the long run. During the past ten years, the aim of economic policy has been to secure the competitiveness of the open sector, mainly by keeping domestic cost increases in check and improving the real competitiveness of the economy. A variety of policies has been employed, consisting mainly of supply-side or positive adjustment measures and increased expenditure on research and development. Furthermore, these policies seem to have produced the desired results, for at the same time as the openness of the economy has increased, equilibrium in foreign trade has also improved. In the 1980s, the external balance has not been such a key concern in economic policy to the extent that it was in the past.

Although labour costs in Finland have continually risen faster than in competitor countries, this has been largely offset by a better productivity performance as a result of a higher rate of investment. Thus, since

CHART 5.
EXPORT PERFORMANCE IN WESTERN MARKETS IN 1960 - 86, 1960 = 100



1. Growth of Finnish exports less growth of structurally adjusted demand
2. Growth of Finnish exports less growth of overall demand

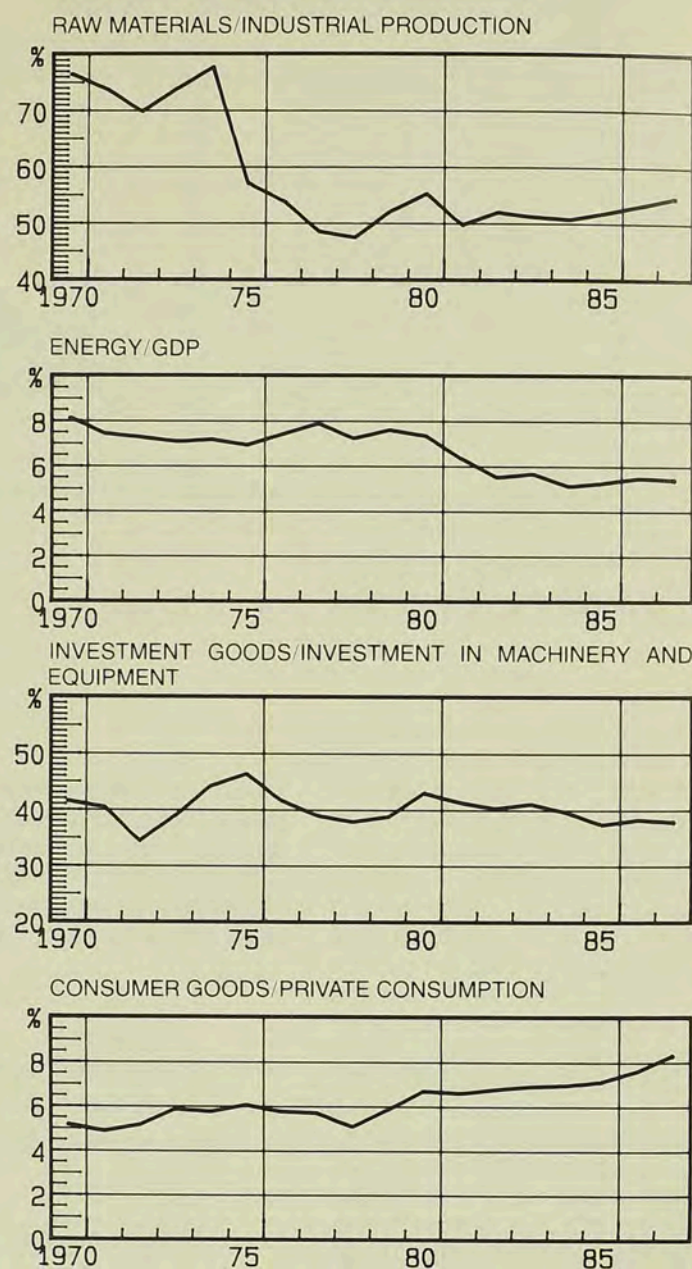
the mid-1970s, the rise in unit labour costs has broadly followed cost developments in competitor countries. Changes in price competitiveness have been small in comparison with past experience, and similarly their effects on the external balance have been modest in the 1980s in relation to, for instance, changes in demand generated by oil price changes. The favourable developments in several components of real competitiveness, such as direct investment abroad, mergers and rationalization, and the energy and corporate tax reforms, have had an even greater significance for the external balance. However, these factors are not included in unit labour costs, the indicator commonly used for measuring international competitiveness.

The slight downward trend in price competitiveness can to a certain extent be explained by improved real competitiveness. Manufacturing investment, which has been higher than in other countries, has sustained rapid productivity growth and has also improved the production structure. This has provided more leeway for pay increases, as a result of which unit labour costs have risen slightly faster than in competitor countries.

Overall developments in market shares of exports since the mid-1970s have been satisfactory. Market shares have been maintained in both nominal and real terms. The improvement of real competitiveness can be seen in the growth of the market shares of Finnish exports adjusted for regional and commodity structure. Finnish exports have grown faster than traditional markets, thanks to the diversification of the domestic product pattern.

On the imports side, the most significant influence on the external balance has derived from investments over the past decade in domestic production substituting for imported raw materials and in-

CHART 6.
IMPORT PENETRATION

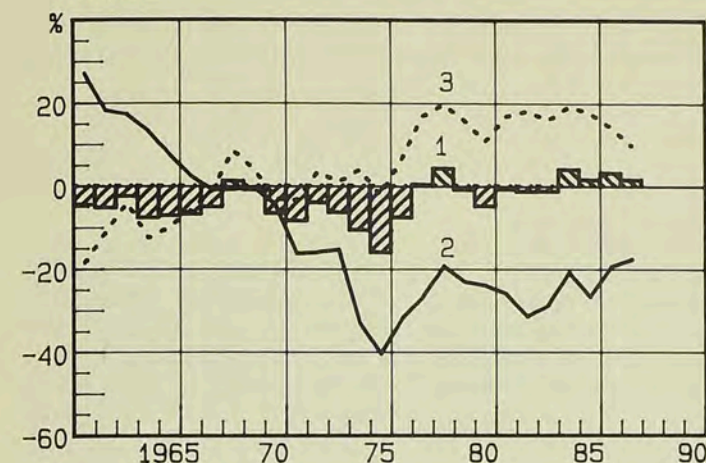


Ratio of various import categories to corresponding domestic demand components

creasing supplies for exports. In fact, the ratio of imports of raw materials to industrial output has clearly diminished. As regards investment goods, domestic suppliers have retained their market shares. By contrast, imported goods have won market shares in the domestic

market in many categories of consumer goods, for example clothing and footwear. In this respect, developments in Finland lag behind those in the rest of Europe, where the division of labour and internal trade within branches has proceeded even further.

CHART 7.
TRADE BALANCES IN RELATION TO THE VALUE OF TRADE



1. Total trade (SITC 0 - 9)
2. Raw materials and energy (SITC 2, 3, 4, 5)
3. Manufactures (SITC 6, 7, 8)

The utilization of foreign trade to make the production structure more diversified and efficient has also been reflected in the structure and balance of the trade account. While, in the 1950s, Finland was a net exporter of raw materials and a net importer of manufactured goods, today the opposite is true. The greater diversification of the industrial structure of the Finnish economy has also meant a reduction in cyclical fluctuations and other disturbances in the external balance. The merchandise trade account, which previously posted large deficits, has moved into surplus in the 1980s, despite the fact that income growth has been faster than in other countries.

SUMMARY

For a country with a small population and domestic market, foreign trade has provided a way of increasing income and wealth more rapidly than would have been possible by relying solely on indigenous

resources. From being a predominantly agricultural country in the immediate postwar period, whose exports were based on forest products with a low level of processing, Finland has developed into a highly industrialized country utilizing the newest technologies and most modern product development. Apart from generating income, the emphasis on exports has allowed a substantial expansion of consumption, thereby making it possible to exploit the benefits of the international division of labour. Increased openness has not, however, entailed any major difficulties as a result of international disturbances. By enhancing real competitiveness, Finland has been able to cope with external shocks reasonably well, without the need to resort to trade barriers and other measures leading to a misallocation of resources.

Over the past ten years, in particular, the Finnish economy has performed notably better than industrial countries on average. Finland has been better able to adjust its products to correspond to changing inter-

national patterns of demand. In addition, the bilateral trade arrangements with the Soviet Union have helped Finland to tide over the difficult periods following the oil crises.

At present, Finland's industrial capacity is relatively modern, thanks to a consistently high rate of investment. Research activity and the increasing participation of companies in foreign markets by way of direct investment have also enhanced real competitiveness. At home, corporate restructuring is still proceeding at a rapid pace, as evidenced by numerous mergers and takeovers. This is designed to ensure that exports continue to make a positive contribution to the economy. Because of the relatively high cost of labour in the domestic market, some production is expected to shift to countries with lower labour costs. However, this will also serve to release resources for technologically more advanced production. In this respect, the overall outlook is favourable, and Finland's growth strategy, the maximum utilization of foreign trade, can continue to bring benefits in the future.

May 31, 1988

STRUCTURAL DEVELOPMENTS IN FOREIGN TRADE

by **Pentti Forsman**, M.Pol.Sc.
Economics Department
Bank of Finland

INTRODUCTION

Over the past forty years, the structure of Finnish foreign trade has, together with the structure of production, undergone major change. From being basically an agricultural country and exporter of raw materials, Finland has developed into an advanced industrialized nation and net exporter of industrial products.

Structural change in exports has been characterized by a decline in the share of less highly processed products. The share of the traditional export branches, the forest industries and forestry, in total exports has decreased from 90 per cent in 1950 to 40 per cent at present. In addition, within the forest industries, there has been a marked rise in the degree of processing. Roundwood, sawn goods and pulp, the less highly processed products which dominated exports as late as the 1950s, have given way to more highly processed paper products.

Forty years ago, the metal and engineering industries accounted for only a minor proportion of Finland's total exports, but today their share is equivalent to that of the forest industries. While previously the bulk of the exports of the metal and engineering industries consisted of heavy machinery products and basic metals, they are now well diversified. Particularly in the current decade, an important contribution to the growth of metal and engineering industry exports has come from high-tech products requiring large inputs in terms of research and development (R & D).

As far as the exports of other industries are concerned, the share of the textile and clothing industry grew strongly from the 1950s onwards. In recent years, however, its share has started to diminish, mainly because of increased supplies from low-cost countries.

The changes in the composition of imports have been less striking. Fluctuations in the oil price have primarily affected the share of energy imports. The share of imports of raw materials other than oil has remained at around half of total imports. Reflecting Finland's high investment ratio, the focus in imports of manufactured goods was previously on investment goods, but the last few years have witnessed an expansion in the relative share of consumer goods.

A noteworthy feature of the long-term developments in the country composition of Finland's trade has been the decreasing share of the United Kingdom and the emergence of Sweden and the Federal Republic of Germany as Finland's most important western trading partners. Finnish-Soviet trade grew strongly along with the increase in the oil price but has subsequently returned to the level prevailing before the oil crises. Finland's chief markets have been in western Europe, whose position has been enhanced by the free trade agreements concluded with EFTA and the EEC.

ECONOMIC POLICY AND THE STRUCTURE OF FOREIGN TRADE

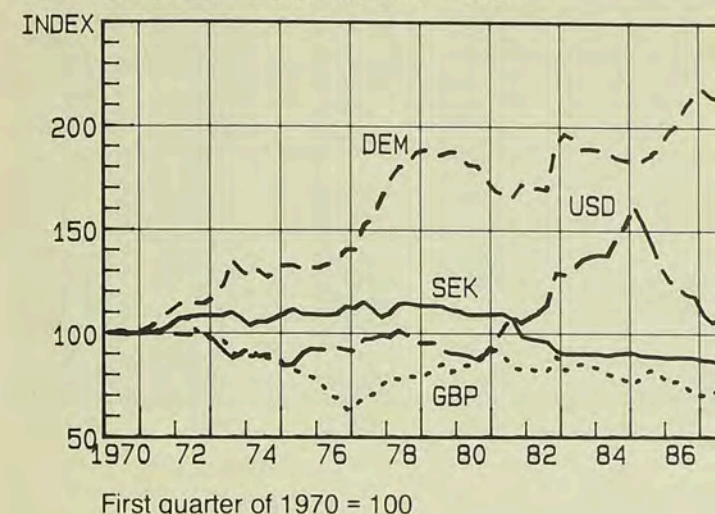
In the period immediately following the second world war,

agricultural land, forests and labour still constituted Finland's main economic resources. Reflecting these resource endowments, exports consisted almost entirely of roundwood and forest industry products with a low degree of processing. Admittedly, Finland already had traditions in exporting paper at that time.

When, in the 1950s, the entire forest area began to be economically exploited, it became clear that measures taken to increase value added in the forest industry would not alone suffice to ensure adequate economic growth. In addition, more labour was being freed from agriculture, which was characterized by the prevalence of small farm holdings, than it would have been possible to employ in other industries without recourse to special measures.

An essential requirement for industrialization and job creation was investment in physical capital and in education and training. The raising of value added in the forest industries and the diversification of the structure of industrial production as a whole were set as targets for economic policy as early as the 1950s. The necessary investment required saving, and in fact the central government itself was an important net saver, a position which it maintained up to the present decade. The central government channelled resources — partly through state-owned companies — to the creation of basic industry in the metal and engineering industries and the chemical industries as well as to domestic energy production. The crea-

CHART 1.
EXCHANGE RATE MOVEMENTS OF THE FOUR
MOST IMPORTANT CURRENCIES IN FINLAND'S
WESTERN TRADE IN 1970 - 1987



tion of an extensive vocational training system increased the supply of labour available to new, rapidly growing industries. In monetary policy, credit rationing was used to channel private sector savings to industrial investment.

Finland's trade policy also played an important role in supporting the strategy of export-led growth. In a small open economy, the benefits to be gained from the expansion and diversification of production could only be achieved through exports. Participation in the process of European integration and the reduction of customs duties in general within the framework of GATT guaranteed markets for Finland's growing output. First the agreement with EFTA in 1961 and then the agreement with the EEC in 1973 made it possible to diversify Finnish exports.¹

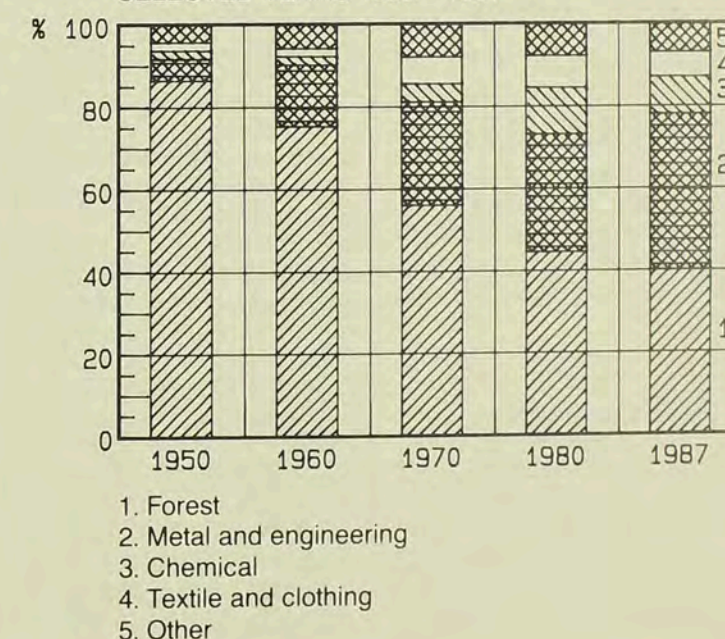
Earlier in the period, exchange rate policy was also used to create conditions con-

ducive to industrialization. Major devaluations in 1957 and 1967 increased the profitability of the export sector and facilitated investment. After the collapse of the Bretton Woods

system, the value of the markka started to be expressed in terms of a trade-weighted currency index. A currency index reduces the impact of exchange rate fluctuations on foreign trade, which at times may be considerable. With the diversification of the structure of production, the role of the authorities has changed during the current decade. Economic policy priorities have shifted from promoting rapid industrial expansion to safeguarding a favourable economic environment in general. Exchange rate policy, for instance, no longer aims at supporting economic growth but at securing adequate stability.

In spite of faster economic growth than in the rest of Europe as a whole, the Finnish markka has remained stable in recent years. As a consequence, the use of the markka as an invoicing currency in foreign trade has increased appreciably, and now accounts for 16 per cent of exports and 20 per cent of imports.

CHART 2.
STRUCTURE OF MERCHANDISE EXPORTS,
SELECTED YEARS 1950 - 1987



¹ See the article "Finland's Trade Policy and Trade Policy Agreements" by Veli Sundbäck in the February 1988 issue of the Bulletin.

STRUCTURAL DEVELOPMENTS IN EXPORTS

The main factors influencing structural change in exports have been Finland's forest resources, investments raising value added in manufacturing, the creation of new industries and developments in wages and salaries. In the early 1950s, almost all export earnings were derived from the forest-based products but other industries employing cheap labour rapidly began to increase their exports. Structural change in exports could not have taken place as quickly as it did without large-scale investments in the industrial base (energy, basic metals and chemicals), all of which were completed by the end of the 1970s. Roughly speaking, the 1950s and 1960s constituted a period of growth in labour-intensive exports; this development was supported by the free trade agreement concluded with the EFTA countries. By contrast, in the 1970s, and to some extent still in the 1980s, the most rapid increase in exports took place in capital-intensive industries, the underlying structure of which had been built in the 1960s and the early 1970s.

During the last twenty years or so, an ever increasing share of exports has relied on highly skilled labour and R & D. This has also meant an increase in the level of wages and salaries, and, particularly in the 1980s, a decrease in labour-intensive exports. Consequently, Finnish exports are mainly composed of capital-intensive products and products with high R & D inputs.

Forest industries

Whereas exports of roundwood still accounted for 10 per cent of total exports in the 1950s, the forest industries must nowadays import an equivalent proportion of their wood requirements. Disruptions in supplies of raw materials in the forest industries

have at times even led to shortages of wood and underutilization of capacity, especially in the sawmill industry. The increase in exports of forest industry products after the mid-1970s can to a great extent be ascribed to a rise in the degree of processing. Value added in the Finnish forest industries is in fact notably higher than it is in Sweden, one of Finland's main competitors, where pulp and other less processed products account for a larger share of forest industry exports.

Although forest industry exports now account for only 40 per cent of total exports, they can be expected to remain the most important category as regards net export earnings. However, the emphasis is likely to shift increasingly towards paper production, the demand prospects for which are good according to FAO estimates. Thanks to forest improvement schemes, the supply of pulpwood should be adequate to meet increased paper exports.

Metal and engineering industries

The war reparations effected to the Soviet Union required the construction of new capacity in the metal and engineering industries, which were to become an expanding export branch when the war reparations were completed. These industries were able to draw on the pool of labour released as a result of increased productivity in the primary sector. Initially, they specialized in meeting domestic demand, especially the investment requirements of the forest industries, and in carrying on trade with the Soviet Union.

Exports to western markets consisted primarily of forest industry machinery and equipment, and from the 1960s onwards also basic metals. The export volume of the metal products industry, for instance, grew slightly faster than total exports from 1960 to 1980. In the 1980s, the exports of the metal and engineering industries

CHART 3.
STRUCTURE OF FOREST INDUSTRY EXPORTS,
SELECTED YEARS 1950 - 1987

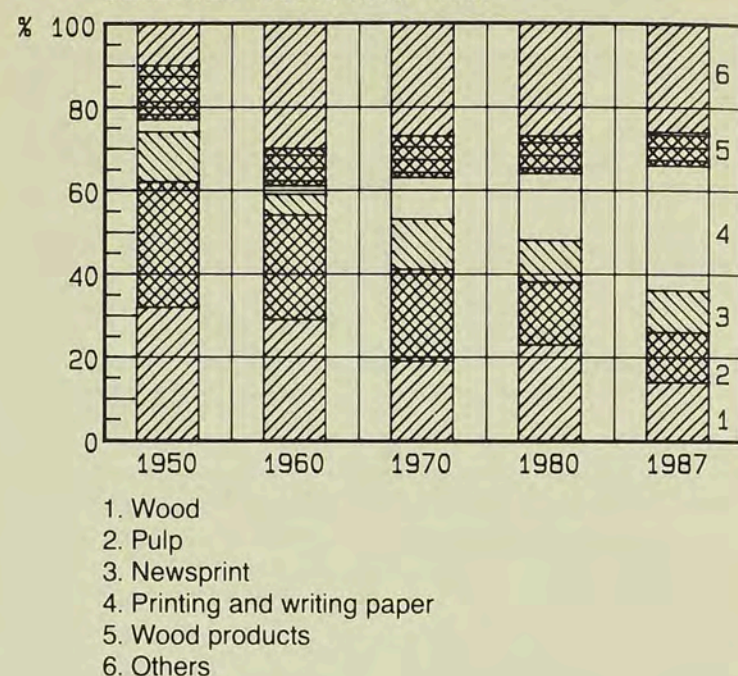
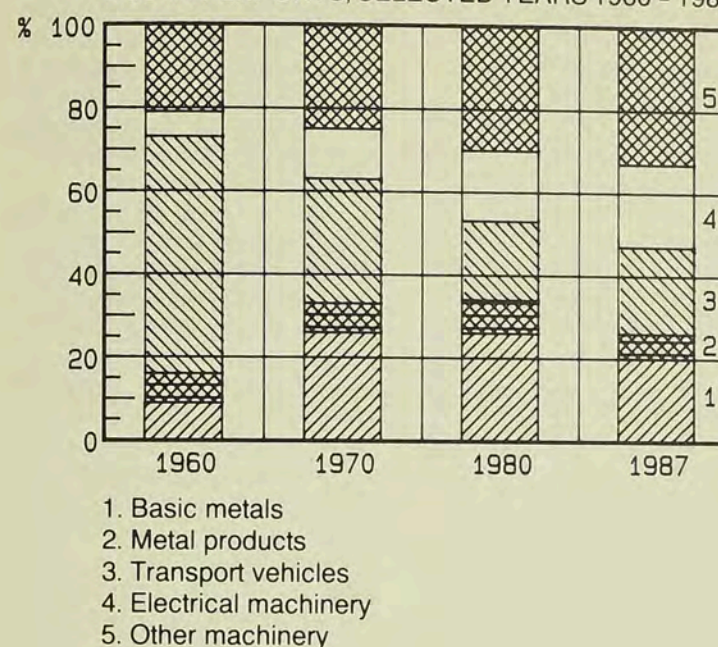


CHART 4.
STRUCTURE OF METAL AND ENGINEERING INDUSTRY EXPORTS, SELECTED YEARS 1960 - 1987



have experienced the fastest growth amongst the manufacturing industries, so that their share in total exports now equals that of the forest industries.

The metal and engineering industries underwent a major restructuring in the 1980s. The country composition of exports diversified and a growing share of exports went to markets other than those in Finland's neighbouring countries, the Soviet Union and Sweden. Further evidence of diversification is to be found in the fact that Finland has become a net exporter in consumer electronics. In the future, the exports of the metal and engineering industries are likely to focus increasingly on special products requiring high R & D inputs.

Other exports

Finland's free trade agreement with EFTA in 1961 provided an impetus to the expansion of other merchandise exports. The textile and clothing industry was the fastest growing export industry in the 1960s.

The growth of exports continued in the 1970s, albeit at notably slower rate. In the 1980s, however, this branch has suffered a setback. Market

shares in OECD countries have shrunk considerably, and its export share has only been maintained because of growing exports to the Soviet Union.

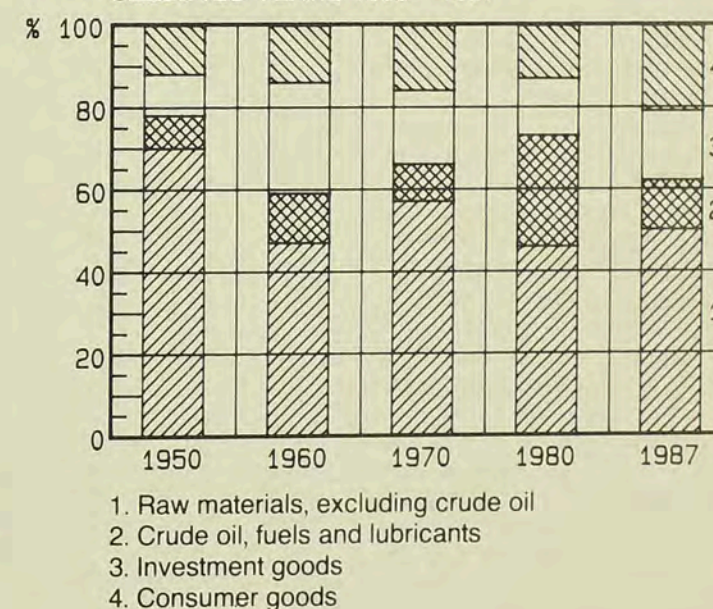
The rapid growth in the export share of the chemical industries is attributable both to investments implemented as early as the 1960s in, for example, the petrochemical industry, and to the refining capacity released as a result of energy savings.

STRUCTURE OF IMPORTS

Imports were regulated up until 1957. Because of a shortage of foreign exchange earnings, priority was given to imports of essential commodities needed in production and investment. Finland's high investment ratio led to an increase in the share of investment goods in total imports in the early 1960s as domestic production was insufficient to satisfy demand.

Structural shifts in imports over the last two decades have primarily been due to fluctuations in the price of crude oil.

CHART 5.
STRUCTURE OF MERCHANDISE IMPORTS,
SELECTED YEARS 1950 - 1987



The share of raw materials and intermediate products has remained at some 50 per cent. The share of finished goods has varied between 30 and 40 per cent, which is noticeably less than in other western European countries. During the past two years or so, the share of consumer goods has risen to some 20 per cent of imports. As the import share of consumer goods is still lower than in other European countries, it is likely to continue rising.

The most striking development in imports in the early 1980s was the contraction in energy imports. While Finland's oil consumption growth was among the fastest in the OECD countries before the first oil crisis, its subsequent decline was also faster than elsewhere. The decrease in oil consumption was rendered possible by the increased supply of indigenous energy, on the one hand, and savings measures, on the other.

Although more than half of investments in machinery and equipment are imported goods, the propensity to import has remained surprisingly stable. Domestic manufacturers of investment goods have been able to adjust their production to meet increasingly demanding investment requirements.

The ratio of imports of raw materials to industrial output fell sharply in the 1970s. This was largely due to major import-substituting investments, particularly in the basic metals and chemical industries. In the 1980s, imports of raw materials have remained at a low level because of the rationalization of corporate inventory control and hence a more rapid turnover of stocks. The increase in imports of raw materials and intermediate goods during the past two or three years reflects the switching of production from eastern markets to western and domestic markets, which has necessitated the increased use of imported intermediate products.

REGIONAL AND COUNTRY COMPOSITION

Although the currency index has helped to mitigate the pressures on trade flows caused by large changes in exchange rates, other problems encountered in world trade have resulted in marked fluctuations in Finnish trade by region and country. This applies particularly to the oil crises and the changes in world demand patterns which they contributed to.

Owing to its geographical proximity and similarities in economic and social structure, western Europe is the principal market area for Finnish exports. Likewise, Finland's geographical location gives her an advantage in the Soviet market.

Changes in exchange rates, demand and the real price of crude oil have been the main factors influencing regional fluctuations in Finnish trade over the last twenty years. The oil price rise and the ensuing recession in the western economies in the first half of the

1980s were offset in Finland by increased exports to eastern markets. Similarly, differences in growth rates between the USA and Europe were reflected in trade. The share of western Europe was at its lowest in 1982 but has since grown as a result of increased demand and exchange rate movements.

The real price of crude oil has also been the main factor behind changes in trade between the Soviet Union and Finland, which is conducted on bilateral terms. As oil accounts for the vast bulk of Finland's bilateral trade imports, changes in its world market price largely determine the prospects for exports to the Soviet Union. The collapse in the oil price in 1986 led to a decrease in bilateral trade. The share of the Soviet Union in total Finnish exports was only 15 per cent last year, compared with about 27 per cent at its highest point in 1982.

The share of OPEC countries in Finnish exports reached its peak when the real price of oil was at its highest. With the fall

in the oil price, exports to the OPEC area decreased rapidly. The share of other, mainly developing, countries in Finnish exports has remained fairly stable, although a slight upward trend has been discernible. Owing to the low level of exports to this region, the debt crisis of the developing countries has had scarcely any impact.

The import share of western Europe, Finland's most important trading partner region, has risen in recent years but has still not regained the level prevailing before the first oil crisis owing to a contraction in the share of the EFTA region. The economic strength of Japan has also been evident in its increased market shares in Finland, which have been gained at the expense of European countries. The share of the USA in Finnish imports has remained relatively stable; it would appear that exchange rate changes do not have as much impact on imports as they do on exports.

The free trade agreement which Finland concluded with the EEC in the early 1970s seems to have resulted in a shift in exports to some extent. However, adjustment has taken place within the present EEC, for the United Kingdom's share of Finnish exports has decreased substantially.

Overall, the shift in exports towards the free trade area has been rather limited. The share of the USA, Japan and other non-European countries in Finnish exports has increased by about 2 percentage points since the 1970s. Hence, the aim of the free trade agreement, to retain Finland's market shares in the integrating markets of western Europe, seems to have been accomplished.

In imports, too, the EEC agreement has meant that the EEC countries have been able to retain their market shares in Finland. In the case of individual products, some EEC countries have won market shares in Finland. For instance, imports of clothing from Italy

have grown markedly in recent years following the removal of customs restrictions.

PROSPECTS

If world trade continues to expand without any major disturbances, then structural shifts in Finland's foreign trade should continue along the same lines as hitherto. In exports, there is likely to be a further increase in value added in forest industry products, with the basic raw material, wood, being used more efficiently than before. In the exports of the metal and engineering industries, the share of products requiring large R & D inputs can be expected to grow, as, too, can the share of "tailor-made" products manufactured according to customers' specifications. By contrast, the relative importance of labour-intensive products in exports will diminish; indeed, it is not even rational in economic terms to compete with low-cost countries.

Structural shifts in imports are likely to be dominated by two developments. While the share of sophisticated consumer goods can be expected to go on increasing along with rising incomes, there will also be an expansion in imports of manufactured goods based on cheap labour.

As Finland's principal export markets are in western Europe, the processes of deregulation and market integration currently in progress there are opening up new opportunities for Finland, too. How these changes will ultimately affect the structure of Finnish foreign trade is still unclear but there is every reason to believe that the outcome will be favourable.

April 27, 1988

TABLE. FLUCTUATIONS IN FOREIGN TRADE BY SELECTED REGIONS AND COUNTRIES IN 1970 — 1987, PERCENTAGE SHARES OF TOTAL EXPORTS AND IMPORTS

EXPORTS	EEC	EFTA	CMEA (EUROPE)	USA	OPEC	JAPAN	OTHERS
1970-72	47.5	23.5	15.5	4.8	1.4	0.3	7.5
1973-75	43.9	23.0	18.7	3.8	2.0	0.7	7.9
1976-78	39.2	22.9	22.2	3.7	3.5	1.0	7.5
1979-81	39.9	22.5	20.9	3.7	4.1	0.9	8.1
1982	35.9	19.0	28.9	3.2	4.7	1.1	7.3
1983	37.2	18.1	27.8	4.1	4.1	1.1	7.6
1984	38.8	19.0	20.7	8.2	3.1	1.3	8.9
1985	37.0	19.7	23.4	6.3	2.7	1.5	9.5
1986	38.3	22.0	22.0	5.4	1.7	1.5	9.0
1987	42.2	22.7	17.1	5.2	1.8	1.4	9.6
IMPORTS	EEC	EFTA	CMEA (EUROPE)	USA	OPEC	JAPAN	OTHERS
1970-72	44.2	23.5	16.9	4.7	2.3	2.5	6.0
1973-75	39.7	23.2	19.9	5.1	3.6	2.4	6.1
1976-78	36.6	21.4	22.7	5.0	4.6	2.7	7.1
1979-81	34.9	17.8	24.6	6.1	6.7	3.2	6.7
1982	34.8	17.3	27.8	6.1	3.2	4.2	6.7
1983	35.0	16.7	28.5	5.7	2.2	5.5	6.5
1984	37.1	17.3	26.2	5.0	1.9	5.6	7.0
1985	38.7	17.2	23.9	5.4	3.0	5.3	6.6
1986	43.1	19.3	18.2	4.8	1.3	6.5	6.9
1987	44.4	18.5	16.9	5.2	1.0	7.1	6.9

FINLAND'S FOREIGN TRADE IN SERVICES

by **Jorma Hilpinen**, Head of Office
and **Pirkko Miikkulainen**, M.Sc.
Exchange Control Department
Bank of Finland

During last ten years or so, the relative importance of different items in the current account and the pattern of fluctuations in them have changed markedly. In the 1960s and 1970s, trade in services closely followed developments in commodity trade. Nowadays, trade in services has characteristics of its own and factor income and expenditure have also grown in importance. Services in this article are defined as in the SNA, excluding unrequited transfers and factor income and expenditure.

Finland's trade in services has displayed very diverse movements over the past two decades. In the 1970s, both service exports and imports grew continuously and the

services account was permanently in surplus. An abrupt change occurred in the early 1980s when the growth of service exports came to a halt and exports even declined in real terms. By contrast, the growth of service imports continued and, in some items, growth accelerated. Consequently, the surplus on the services account, which at its peak in 1981 had totalled FIM 5 billion, or more than 2 per cent of GDP, disappeared and in 1987 the services account showed a deficit for the first time (Chart 1).

Service exports and imports each account for about 4 per cent of Finland's GDP, which is approximately the same as in OECD Europe on average. Service exports accounted for almost one-fifth of total current

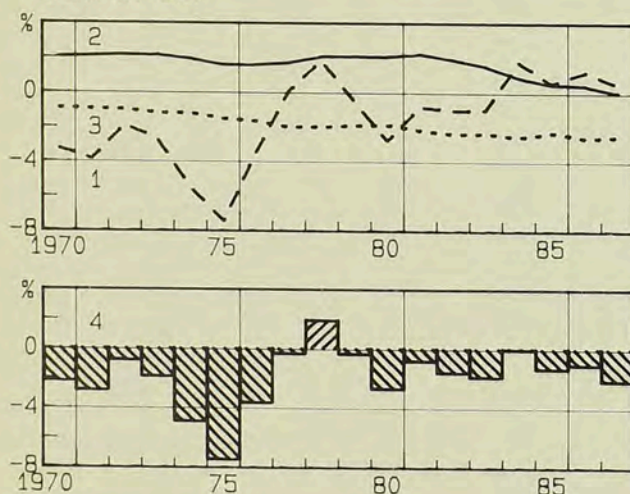
account receipts in the early 1970s, but subsequently their share has gradually declined and amounted to 13 per cent in 1987. The trend in service imports has been just the reverse, their share of current account expenditure rising from less than 10 per cent to 13 per cent.

Though services account for a relatively minor share of current account receipts and expenditure, developments in them are nevertheless important for Finland's external balance (Chart 2). It is therefore worth examining the factors underlying the recent deterioration in the services account and the prospects for trade in services. Present trends would seem to point to structural deficits, because only a small part of the changes may be reversible. The results reported below are derived from a forthcoming Bank of Finland study of factors affecting trade in services. This study brings out more clearly than previous analyses the importance of price competitiveness in trade in services. In addition to activity and price variables, the demand for various services is affected by special factors, which not only explain developments in the past but help in forecasting the future.

DEVELOPMENTS IN TRADE IN SERVICES FROM THE 1960s TO THE PRESENT

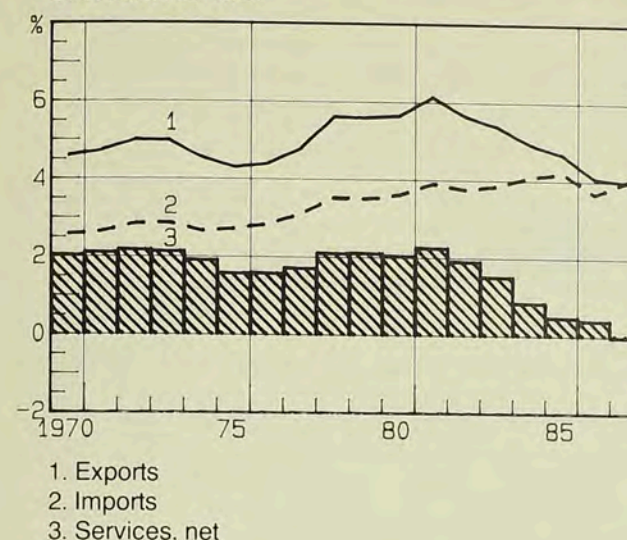
The present significance of trade in services can be illustrated by comparing it to the main categories of commodity trade. Receipts from services are nowadays equivalent to approximately half of the export earnings of the paper industry

CHART 1.
MAIN CURRENT ACCOUNT COMPONENTS, PER CENT OF GDP



1. Merchandise trade
2. Services
3. Investment income and unrequited transfers
4. Current account

CHART 2.
EXPORTS AND IMPORTS OF SERVICES AS A PERCENTAGE OF GDP



1. Exports
2. Imports
3. Services, net

or the metal and engineering industry. Similarly, service imports are equal in value to imports of investment goods. However, trade in services consists of many heterogeneous groups of services, which are often statistically difficult to identify and separate from each other and even from merchandise trade.

In the following, developments in the three main categories of trade in services — transport, travel and other services — since the 1960s are surveyed. Other services include, for example, trade in know-how and building projects abroad.

TRANSPORT

During the 1960s, transport receipts grew in line with or even faster than commodity trade, and, in the early 1970s, accounted for 9 per cent of current account receipts. The large fluctuations in business conditions in 1970s were also reflected in transport receipts; for example, in the recovery of 1976–1979 following the first oil shock they grew in volume by almost 10 per cent a year on average.

In the 1970s, new transport and cargo management tech-

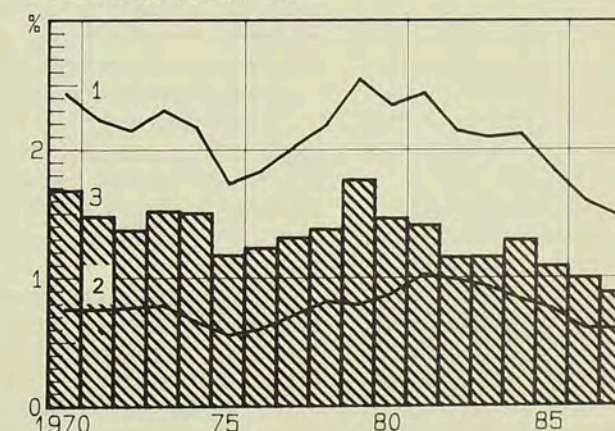
niques were introduced worldwide and new vessels were built. World tonnage increased despite a stagnation in world trade. Excess capacity built up, later leading to stagnating freight rates and consequently low profitability. These developments, combined with relatively high labour costs on Finnish vessels, resulted in a drastic reduction in the Finnish merchant fleet in the mid-1980s as

ships were sold abroad or transferred to registers in other countries. Today, Finnish tonnage is only one-third of what it was in 1980.

The fall in transport receipts has not, however, been of the same magnitude because passenger traffic and road transportation have continued to grow. Thus, the share of transport income in current account receipts has only fallen from 7 per cent in 1980 to some 5 per cent last year. In real terms, transport receipts have been declining by some 10 per cent a year on average over the past three years, during which time the transfer of ships to foreign registers has been at its height.

Transport expenditure in the balance of payments compiled on an f.o.b. — c.i.f. basis consists mainly of costs of transport firms. The transportation costs of imported commodities are included in the c.i.f. value of commodity imports. Consequently, when the scale of operations and earnings of transport firms diminish, their costs decrease, too. Hence the long-lasting surplus on the transport account has deteriorated only modestly, amounting to FIM 3 billion, almost 1 per cent of GDP, in 1987 (Chart 3). When

CHART 3.
TRANSPORT RECEIPTS AND EXPENDITURE AS A PERCENTAGE OF GDP



1. Receipts
2. Expenditure
3. Transport, net

calculated on an f.o.b. — f.o.b. basis, the transport account showed a deficit of about FIM 1 billion last year. During the 1970s and 1980s, the f.o.b. — f.o.b. transport account was in balance on average.

TRAVEL

In the early 1960s, international travel to Finland was still in its infancy; tourist income accounted for less than 2 per cent of current account receipts. Travel expenditure, however, had already reached 3–4 per cent of current account expenditure, at which level it remained until just a few years ago.

The growth of travel income accelerated appreciably after the devaluation of the markka in 1967, and in relative terms travel income reached a peak of 6 per cent of current account receipts in 1972. Heavy net emigration from Finland to Sweden was also an important factor boosting travel income in the early 1970s as emigrants spent their holidays in their native country. Later, a similar period of buoyant growth followed in the wake of the 1977–78 devaluations. These exchange rate changes coincided with upturns in economic activity in Europe. By contrast, the early 1980s were years of low growth in many countries important for Finland's tourist income. The volume of travel receipts declined every year from 1982 to 1986. For the 1980s as a whole, the average annual decrease has been about 2 per cent and the share of travel income in total current account receipts has gone down to 3 per cent.

Price relations with Sweden play a key role in the determination of travel receipts since about half of them are in Swedish krona. During the 1980s, relative prices (including the effect of exchange rate changes) between Finland and Sweden have developed unfavourably from Finland's point of view. This has also affected the border trade between the two

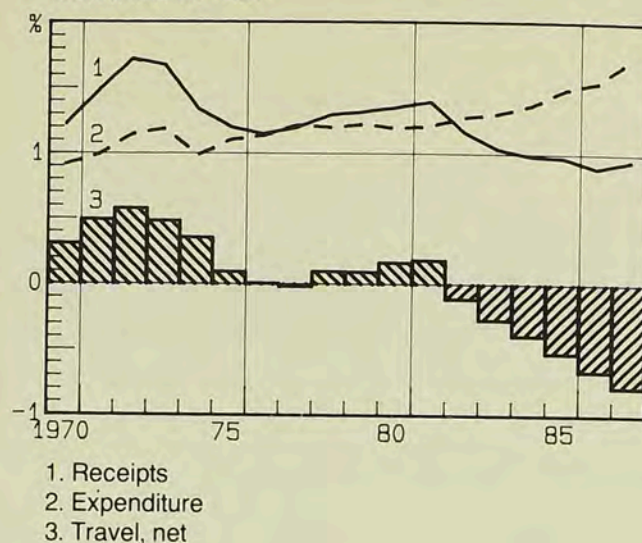
countries, which is highly sensitive to relative price changes.

In spite of the relatively good performance of Finland's price competitiveness overall, in travel it has weakened in relation to nearly all countries important for Finland's tourist income. During the 1980s, the annual rise in consumer prices in Finland has, on average, been 2 percentage points faster than in these countries.¹ The rise in prices of restaurant and private services, in particular, has exceeded that of consumer prices on average. Consequently, foreign tourists in Finland have had to face very high prices for travel services, and indeed these prices have been clearly the fastest growing item in Finnish export prices. From being still a relatively cheap country for foreign tourists in the early 1970s, Finland now ranks among the most expensive.

Travel expenditure grew at the same pace as, or even faster than, household income during the 1960s and 1970s. Foreign travel came within the

¹ Five countries: Sweden, the Federal Republic of Germany, the UK, the USA and Norway.

CHART 4.
TRAVEL RECEIPTS AND EXPENDITURE AS A PERCENTAGE OF GDP



reach of the ordinary consumer as technological progress lowered the relative prices of overseas flights and cruises. During the 1980s, developments in household income in Finland have been very favourable and the personal savings ratio has fallen. Private consumption has grown notably faster than in the countries important for Finland's travel account. Consequently, the share of services, and particularly foreign travel, in consumer expenditure has risen. The ratio of travel expenditure to private consumption went up from 1.5 per cent in 1970 to 3 per cent in 1987. However, it should be noted that travel expenditure also includes the rapidly growing component of business travel, which is not part of private consumption. In real terms, travel expenditure has increased, on average, by 10 per cent annually in the 1980s.

After being slightly in surplus throughout the 1970s, the travel account turned into deficit in 1982 (Chart 4). In 1987, the deficit was already FIM 3 billion — almost 1 per cent of GDP — and travel accounted for 6 per cent of current account expenditure. In the Scandinavian

countries, expenditure on foreign travel constitutes an even larger part of household outlays than in Finland. Given the similarity of Nordic countries, it can be concluded that the saturation point in Finland still lies far ahead.

OTHER SERVICES

Other services comprise a heterogeneous group of items, of which the most important are planning, contracting, know-how and fees related to trade in goods and services (Table 1). An upward trend can be discerned in other services despite large variations in annual growth. The share of exports of other services in current account receipts has risen from 3.5 per cent in 1970 to 5.5 at present, reaching a peak of 7 per cent in 1982. Imports have risen from 3 per cent to 5.5 per cent over the same period.

TABLE 1. MAIN COMPONENTS OF TRADE IN OTHER SERVICES IN 1987

	Value 1987, billion FIM	Income	Expenditure
Planning, contracting, know-how	1.3	1.4	
Commissions, agent's fees etc.	1.3	1.4	
Advertising, marketing	0.3	0.7	
Processing, contract manufacture	0.5	0.1	
Maintenance and repairs	0.6	0.1	
Diplomatic missions	0.1	0.3	
Miscellaneous, non-specified items	1.4	1.8	
Total other services	5.5	5.8	

The volume of Finnish building projects abroad depends heavily on the balance of Finland's trade with the Soviet Union, which in turn is dependent on the price of crude oil. After the oil price shocks, bilateral trade with the Soviet Union was balanced by increasing Finnish exports, including major building projects. Finland's contracting exports to the Middle East also increased. Earnings from construction projects abroad were at their maximum in 1982–83, when the surplus in the other services account was

FIM 2 billion (2 per cent of GDP) in each year. There was an abrupt turnaround in 1984. Low oil prices and the accumulated surpluses in Finnish-Soviet trade will keep contracting exports in check in the near future as well (Chart 5).

FINLAND'S TRADE IN SERVICES: AN INTERNATIONAL COMPARISON

Developments in Finland's trade in services have tended to follow the pattern in other industrialized countries with a lag. It should be remembered, however, that international comparisons are very difficult owing to measurement and classification problems in compiling statistics.

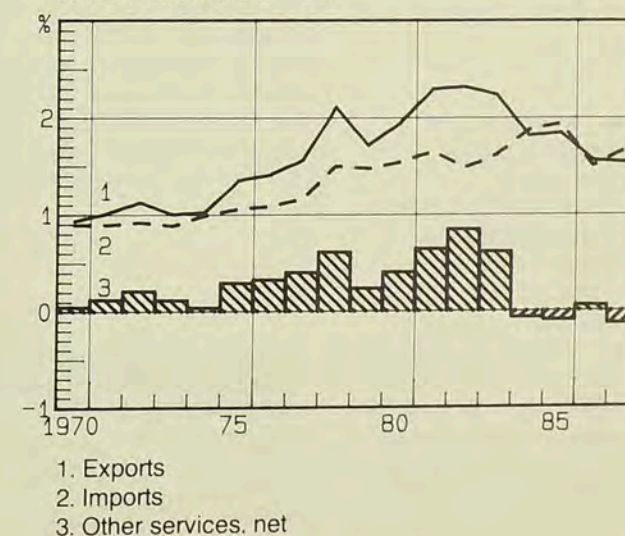
In many European countries, trade in services accounts for a much larger share of GDP than it does in Finland. Such countries typically have a special advantage in producing services. European countries with a high ratio of service exports to GDP (more than 8 per cent in 1986) include Austria, Norway, Switzerland, Spain and the Netherlands. Often countries with a high share of service exports also have a

high propensity to buy foreign services, as, for example, Norway, Austria and the Netherlands. On the other hand, commodities tend to dominate the foreign trade of countries with strong industrial traditions, thus dwarfing the relative importance of what as such is buoyant trade in services (as is the case, for example, in the Federal Republic of Germany and Sweden).

In the 1970s, when international trade in services was expanding at its fastest, Finland was no exception to the overall pattern. In Finland, as in many other OECD countries, the services account was in surplus. The surpluses can partly be explained by the exceptionally high level of service exports to the oil producing countries, whose oil revenues had increased many times over. During the 1980s, international activity in construction projects has diminished.

Finland, like many other OECD countries, is increasingly buying labour-intensive services from low-cost countries. Competition from these countries led, in the late 1970s, to a sharp decline in the share of OECD countries in world ship-

CHART 5.
EXPORTS AND IMPORTS OF OTHER SERVICES AS A PERCENTAGE OF GDP



ping tonnage. The transfer of Finnish vessels to foreign registers lagged this international trend by some years.

Travel receipts in relation to GDP in Finland are markedly lower than in other Nordic countries and in the OECD on average. Over the last few years, developments in travel receipts have been more favourable for other Nordic countries than for Finland.

Travel abroad is still more common among residents of other Nordic countries than it is among Finns, despite Finland's spectacular growth in this area. Finland reached the OECD Europe average of 2.6 per cent for the ratio of travel expenditure to private consumption in 1985. Nevertheless, Norway (6.8 per cent) and Denmark (5.3 per cent) still ranked far ahead of Finland (3.1 per cent) in 1987.

As in most other European countries, incomes and costs in Finland have reached a level where more and more services are being bought abroad. Indeed, deficits on the services account have virtually become the rule in Europe during the 1980s. The highly industrialized countries of Europe can achieve trade gains by exporting commodities and importing low-cost services. As regards travel, there is no point in Finland trying to compete with mass tourism countries. Finland should nevertheless be able to maintain its attraction in competition with other Nordic countries.

CALCULATIONS OF THE EFFECTS OF INCOME AND RELATIVE PRICES ON TRADE IN SERVICES

The study mentioned above suggests that, at the margin, trade in services reacts significantly to changes in income and to changes in relative prices. Moreover, for some service categories, conventional demand models must be supplemented with variables describing the special features

of various service items so as to achieve satisfactory results.

According to the calculations, a change in the level of foreign activity gradually leads to a more than twofold change in Finnish transport and travel receipts. The effect of changes in relative prices is negligible as regards transport income but clearly more than unity in the case of travel receipts. The results for travel expenditure are very similar to those for travel receipts. The effects of changes in income and relative prices are even more prominent for imports and exports of other services (Table 2).

TABLE 2. ELASTICITIES¹ IN VARIOUS SERVICE CATEGORIES

Category	Income elasticity	Relative price elasticity
Transport receipts ²	2.5	-0.2
Travel receipts	2.0	-1.8
Travel expenditure	2.2	-1.4
Other services receipts	3.1	-2.5
Other services expenditure	2.0	-2.6
Total exports of services	1.9	-1.6
Total imports of services	2.2	-1.9

¹ Percentage change in the demand for various services resulting from a one per cent change in income or relative prices.

² For transport expenditure, not feasible; see the relevant section above.

Compared with earlier studies, the effects of relative prices receive more emphasis and the price elasticities are bigger. According to the estimations, the major part of the adjustment of trade in services to changes in both income and relative prices takes place within a year.

CONCLUSIONS AND OUTLOOK FOR TRADE IN SERVICES

Past history and estimation results confirm that, as regards trade in services, Finland has become a high-income, high-

cost country. It is typical of such countries with no special advantages in the production of services that the service account is in deficit. The present trend in Finland's trade in services towards continuing deficits will be difficult to reverse. There can be no doubt that the traditionally positive contribution of trade in services to the stability of the current account no longer holds true. This underlines the importance of commodity trade in securing external balance. Here Finland has relative advantages in the form of its forest resources and its high general level of education.

In transport, the prospects are highly dependent on international economic activity, since the structural effects of the transfer of Finnish vessels to foreign registers seems to be decreasing; the merchant fleet has dwindled to the extent that a further significant decline seems unlikely. In the future, transport income is likely to derive increasingly from passenger traffic and road transport. Assuming international and domestic economic developments in line with those in OECD and official Finnish forecasts, the above calculations suggest that surpluses of the present magnitude (less than one per cent of GDP annually) are likely to continue.

As regards the travel account, the deficits seem likely to go on increasing and could soon surpass one per cent of GDP. The share of households' consumption going on foreign travel will increase further as rising incomes make travel abroad increasingly attractive. Foreign tourism in Finland is, at best, expected to remain on a slowly growing trend.

In other services, success in winning building and planning contracts in traditional markets in the Soviet Union and the Middle East will depend crucially on the price of the crude oil. However, the significance of real and price competitiveness

cannot be overemphasized if markets are to be expanded. The current outlook for traditional exports of other services is not very promising and imports of know-how and technology are on the increase. Thus, deficits on this account seem more probable than surpluses.

Viewing trade in services as a whole, Finland has undergone a period of major structur-

al change, which now seems to be coming to an end. Service receipts, in particular, have experienced a drastic downward shift within the space of just a few years. Developments in service expenditure have been more stable. Based on these considerations, a continuation of deficits in trade in services would seem likely. However, given the variety of other ser-

vices, there may be scope for increasing exports and thus for greater stability in the services account.

November 4, 1988

FINLAND'S TRADE AND ECONOMIC COOPERATION WITH THE CMEA COUNTRIES

by **Terhi Kivilahti**, Head of Office
Bilateral Trade Department
Bank of Finland

Finland has consistently sought to increase trade and promote economic cooperation with all countries regardless of their economic and social systems. Fifteen years ago, Finland was the first market economy to sign an agreement on cooperation with the CMEA. Finland's trade with CMEA countries experienced exceptionally rapid growth in the 1970s and early 1980s, which was largely attributable to the increase in oil prices and the bilateral trade system. At its peak, trade with the CMEA countries accounted for over one-quarter of Finland's total foreign trade. The Soviet Union accounts for the bulk of this trade, and has, in fact, almost invariably been Finland's largest single trading partner during the last 15 years. Now that the price of oil has fallen, the share of trade with the CMEA countries has returned to the average level of the 1970s.

Exports to the Soviet Union are important for Finland because of their high degree of processing and labour intensity. Imports from the Soviet Union play a key role in Finnish energy supply. During the 1980s, the clearing account has shown an almost permanent claim in Finland's favour and a number of special arrangements have been introduced both to maintain a high level of trade and to balance trade.

TRADE AGREEMENT SYSTEM

The year 1973 was a significant one for major trade policy decisions. In connection with

the free trade arrangements with the EEC, Finland proposed negotiations to the Eastern European CMEA countries (excl. the Soviet Union) on the reciprocal removal of the remaining trade barriers. The Soviet Union had been guaranteed the same benefits in a customs agreement as early as 1961 in connection with the EFTA arrangements. Agreements on the reciprocal removal of barriers to trade were concluded in 1974 — 78. Those socialist countries with no effective tariffs made corresponding concessions within their own systems in order to safeguard the development of Finnish exports in their own markets. In the same context, the use of annual trade protocols on the exchange of goods, which are one of the main ways of regulating balanced bilateral trade, was discontinued.

The CMEA charter provides for cooperation between the organization and countries representing different economic systems. Finland's agreement with the CMEA was also signed in 1973 and it is based on the principle of cooperation as Finland is not a member of the CMEA, and does not participate in the activities of its agencies or monitor their operations as an observer. CMEA cooperation seeks to chart the potential for cooperation, issue recommendations and monitor their implementation. Some one hundred economic or scientific-technological agreements aimed at multilateral cooperation have been signed on the basis of the recommendations of the Finnish CMEA commission.

Currently Finland has bilateral trade and payments arrangements only with the Soviet Union, the German Democratic Republic and Bulgaria. In the early 1970s, Finland's trade and payments with the other socialist countries were also based on the clearing system regulated by bilateral payments agreements. During the 1970s, the clearing payments arrangements were discontinued with those CMEA countries which joined the IMF, in compliance with the Fund's requirements.

Under the clearing system, the parties to the clearing agreement are committed to spend their export earnings only on the goods of the other party. Payments are effected through centralized clearing accounts in the agreed clearing currency and the balance on the account may not be used for purchases from third countries. This kind of a bilateral payments system usually comprises a payments agreement and annual protocols on the exchange of goods, which are designed to keep reciprocal trade at a level maintaining balance on the clearing account. Another way of maintaining balance on the clearing account is to agree on certain credit limits. Should the balance on the clearing account exceed the limits, the parties take the steps required under the payments agreement to redress the imbalance. For instance, the payments agreement between Finland and the Soviet Union has, hitherto, provided for negotiations on an increase in exports by the debtor country if the clearing account balance exceeds the credit limit for three

TABLE. AGREEMENTS AND PAYMENTS ARRANGEMENTS IN FINLAND'S TRADE WITH THE CMEA COUNTRIES

	USSR	POLAND	CZECHO-SLOVAKIA	GDR	HUNGARY	ROMANIA	BULGARIA
TRADE AGREEMENT	Agreement on Exchange of Goods and Payments 1986—1990	Trade agreement 1971—1975 still in force	Long-term trade agreement 1974 still in force	Trade agreement 1973 (1983) in force until 1988 ¹		Trade agreement 1982—1992	Long-term trade agreement 1973 (1981) partly in force
PAYMENTS SYSTEM	Clearing (Rouble) Credit limit SUR 300 million	USD since 1970 FIM since 1986	Convertible currencies, since 1984	Clearing (FIM) Credit limit FIM 70 million	Convertible currencies since 1985	Convertible currencies since 1982	Clearing (FIM) Credit limit FIM 25 million
COOPERATION	Scientific and technical cooperation Economic, technical and industrial cooperation Agreement on the Establishment of a Standing Intergovernmental Commission for Economic Cooperation	Economic, industrial, scientific and technical cooperation	Economic, technical and industrial cooperation Long-term programme on the development of economic, industrial, scientific and technical cooperation	Economic, industrial, scientific and technical cooperation	Economic, industrial, scientific and technical cooperation	Economic, technical and industrial cooperation	Economic, industrial, scientific and technical cooperation Long-term programme on the development of economic, industrial, scientific and technical cooperation
OTHER	Customs agreement Long-term programme up to 2000	Agreement on the Reciprocal Removal of Barriers to Trade in 1978	Agreement on the Reciprocal Removal of Barriers to Trade in 1974	Agreement on the Reciprocal Removal of Barriers to Trade in 1975	Agreement on the Reciprocal Removal of Barriers to Trade in 1974		Agreement on the Reciprocal Removal of Barriers to Trade in 1974

¹ After 1988, the agreement will continue automatically for one year at a time unless it is cancelled.

months running. Should this not be sufficient to settle the liability, the creditor country has been entitled to discontinue its export deliveries or require that the liability in excess of the credit limit be paid in convertible currencies.

Finland's trade with the Soviet Union is planned and regulated by means of 5-year agreements on the exchange of goods and payments and annual protocols on the exchange of goods. The 5-year framework agreement lists in broad outline the goods to be exchanged and defines the payments arrangements. Detailed quotas for imports and exports are agreed on in annual trade protocols. When drawing up the protocols the clearing account position is taken into account and efforts are made to set the total values of exports and imports so that balance can be achieved on the clearing account.

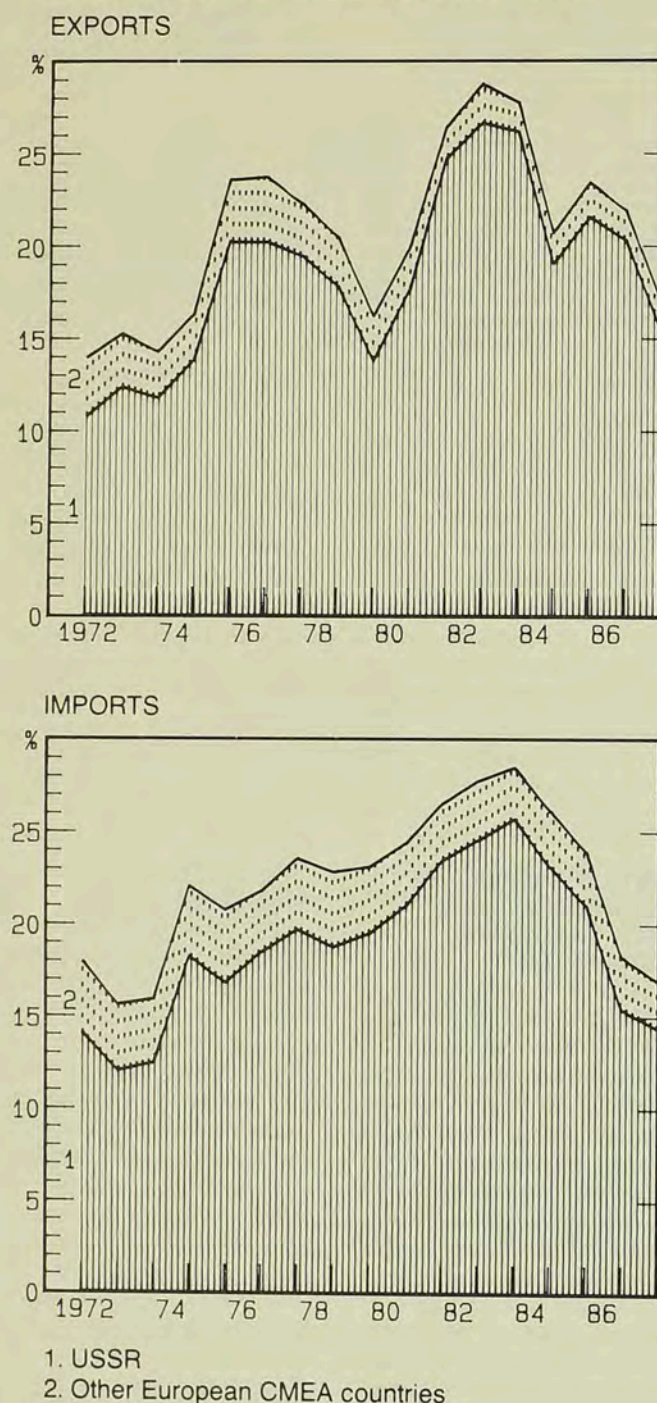
DEVELOPMENTS IN FINLAND'S TRADE WITH THE CMEA COUNTRIES

In 1970-87, Finland's trade with the CMEA countries accounted for about 20 per cent on average of Finland's total foreign trade. The Soviet Union dominates trade with the CMEA countries, with a share of 85 per cent on average. The other Eastern European CMEA countries are of minor importance for Finnish foreign trade, accounting for only some two per cent annually on average. The scope for increasing trade has diminished in the 1980s as some CMEA countries have become heavily indebted and their weakened international competitiveness has hampered the growth of their trade with western countries. In 1965, exports to the CMEA countries other than the Soviet Union still accounted for 4—5 per cent of Finland's total exports.

Although the share of the other CMEA countries in Finland's foreign trade has declined in the years following the signing of the agreements on the reciprocal removal of barriers to trade, Finland seems to have been able to maintain its position in CMEA markets fairly well. In the early 1970s, Finland accounted for just over one per cent of CMEA imports from western markets, whereas its share has averaged some 2 per cent during the past five years.

From the 1950s to the mid-1970s, trade with the Soviet Union made up some 15 per cent of Finland's total foreign trade on average. In the latter half of the 1970s, it grew to just under 20 per cent and in the first half of this decade it amounted to almost 25 per cent as a result of the oil price rises; with the fall in the oil price the level has dropped to the average level for the period from the 1950s to the 1970s. Finland has also been

CHART 1.
PERCENTAGE SHARES OF THE CMEA COUNTRIES
IN FINLAND'S FOREIGN TRADE (1971 - 1987)



Source: Official Statistics of Finland, Foreign Trade

able to maintain its position in the Soviet market, with a share of some 15 per cent of the Soviet Union's western trade in the last five years.

In 1970—85, Finnish exports to the Soviet Union grew at an annual average rate of 7 per cent, i.e. twice as fast as exports to western markets. The rapid

growth was due both to the surge in oil prices over the same period and to the bilateral trade system. The structure of exports to the Soviet Union differs from that of western exports; in exports to the Soviet Union, the metal and engineering industries, the forest industries and the textile, clothing, leather and footwear industries have large shares, whereas exports to western markets are dominated by forest industry products.

Changes in oil prices have influenced the growth of trade and developments in the current account. Exports have varied mainly as a result of changes in the value of imports. While fluctuations in exports to the Soviet Union have been large compared with those in exports to other countries, in the 1970s, in particular, they have served to cushion economic activity in Finland against the effects of international business cycle fluctuations resulting from the increase in oil prices. The weakening of the terms of trade did not lead to lower employment or output as the increase in import prices focused on the trade with the Soviet Union, which it was possible to increase because of the balancing mechanism provided for under the bilateral arrangements.

Because of the increases in energy prices, the value of bilateral trade between Finland and the Soviet Union reached its highest levels in 1982 and 1985, since when the value of trade has fallen. In 1986, the sharp fall in the world market price of crude oil decreased the value of Finnish imports by almost one-third. The fall in the oil price has created a new situation for the trading partners, and as a result some new features have emerged in the trade.

The Soviet Union has delivered oil for trading with third countries to pay for an average of 10 per cent of Finnish exports to the Soviet Union during the

last five years. In 1981—86, clearing imports from the Soviet Union based on Finland's own demand covered 89 per cent of Finland's clearing exports. In addition, the Soviet Union has paid for just over 3 per cent of the commodities bought from Finland in convertible currencies in the 1980s. At the end of 1987, Finland's clearing account claim on the Soviet Union was about one-fourth of the value of exports in the same year.

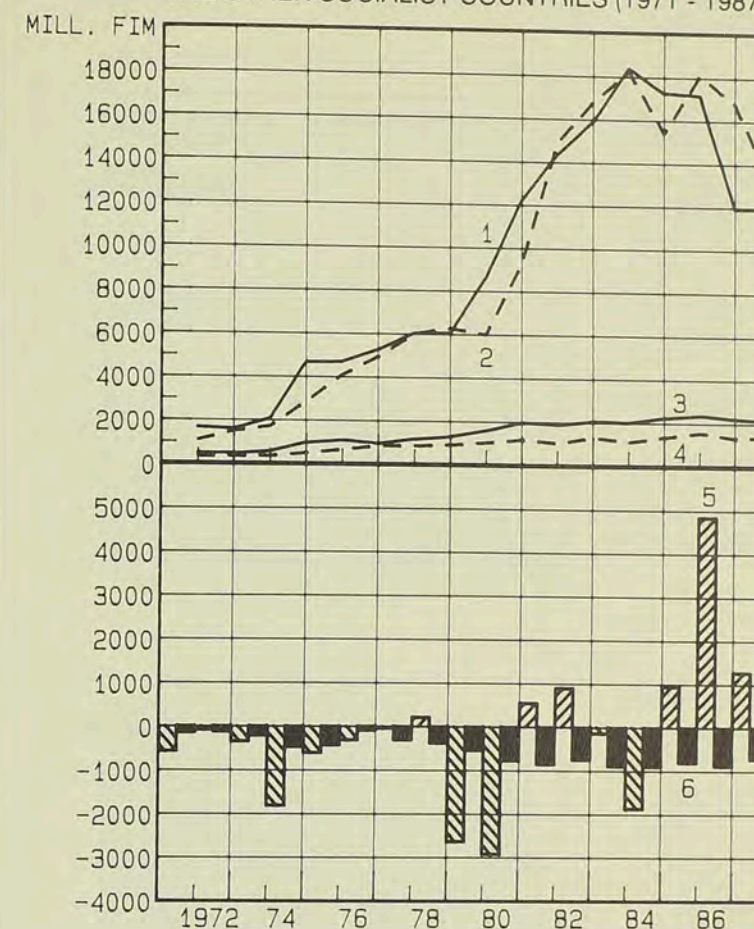
Raw materials and energy have made up over 90 per cent on average of Finland's imports from the Soviet Union in the 1970s and 1980s. Energy imports have accounted for over 80 per cent of Finland's total imports from the Soviet Union in the 1980s as the share of energy purchased from the Soviet Union in Finland's total purchases of energy abroad was raised in order to restore balance to the trade. Finland imports practically all the crude oil and all the natural gas it needs and substantial amounts of coal, electricity and nuclear fuel from the Soviet Union.

Efforts have been made to diversify imports and especially to increase the share of machinery and equipment. At present, they account for some 10 per cent of imports and Finland is, in fact, the main western buyer of Soviet machinery and equipment.

IMPORTANCE OF TRADE WITH THE SOVIET UNION FOR THE FINNISH ECONOMY

Trade with the Soviet Union is of great importance for the Finnish economy. First, exports to the Soviet Union are more labour intensive and involve a higher degree of processing than other exports, and therefore the effect of exports to the Soviet Union on employment is significant. In the early 1980s, when exports were at their peak, they were estimated to have provided employment for some 140,000 people (incl.

CHART 2.
EXPORTS, IMPORTS AND TRADE ACCOUNTS BETWEEN FINLAND AND THE SOVIET UNION AND THE OTHER SOCIALIST COUNTRIES (1971 - 1987)



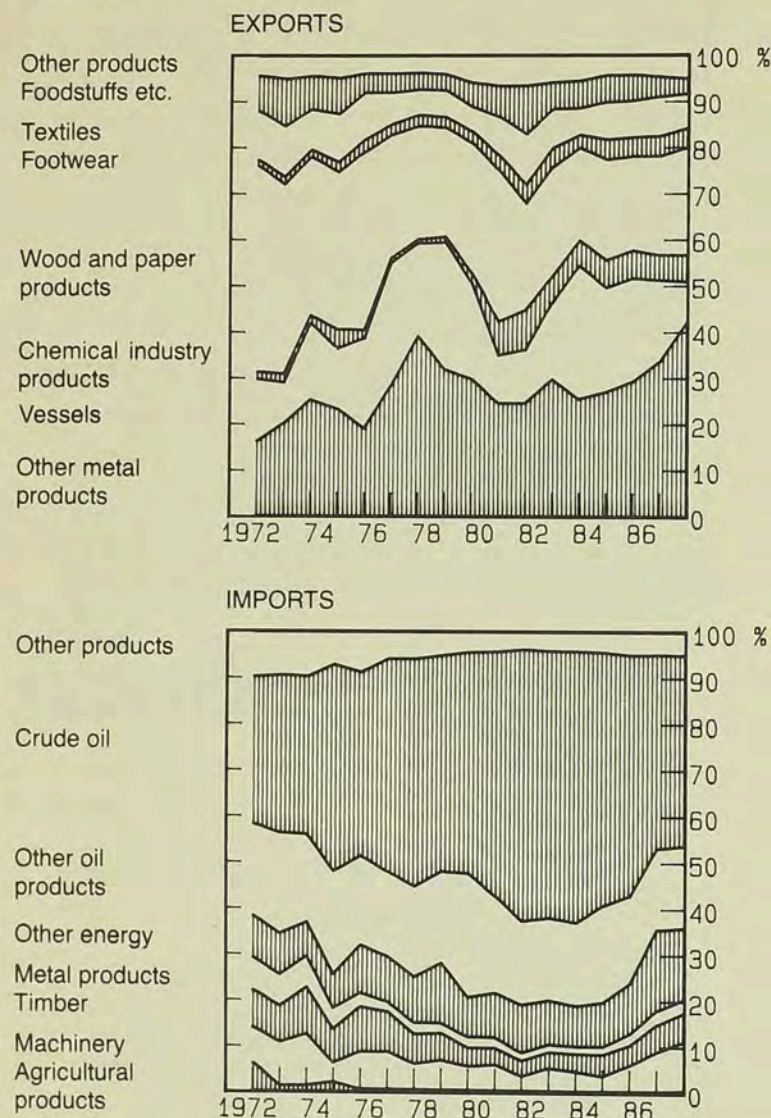
Source: Official Statistics of Finland, Foreign Trade

the multiplier effect). Now the employment impact has reverted to the level of the early 1970s, i.e. to some 70,000 people. A substantial part of the exports and production of several manufacturing sectors is delivered to the Soviet Union and these industries are specialized in deliveries to the Soviet market.

The sectors specializing in exports to the Soviet Union are the metal and engineering industries, the food industry and

the textile, clothing, leather and footwear industries. Hence, these sectors, in particular, have been affected by the adjustment problems caused by the cutback in exports. About one-third of metal and engineering industry exports goes to the Soviet Union. In 1980—85, the Soviet Union bought over half of all the vessels built in Finland. Over the same period, almost 20 per cent of the production of the textile, clothing, leather and

CHART 3.
STRUCTURE OF FINLAND'S TRADE WITH THE SOVIET UNION (1971 - 1987)



Source: Statistics compiled by the Trade Department of the Ministry of Trade and Industry

footwear industries also went to the Soviet Union. The vigorous growth in the exports of the food industry in the 1970s and 1980s was attributable to exports to the Soviet Union; in the first half of the 1980s, some 50 per cent of the food industry's exports on average went to the Soviet Union.

The Soviet Union's share in the total exports of the forest industries has varied between 10 and 20 per cent. The share of forest industry products in Finland's exports to the Soviet Union has been significant. However, it has fallen during the 1970s and 1980s and now accounts for about one-fifth.

FINANCING AND SPECIAL ISSUES

In the 1980s, fluctuations in trade and payments flows have been sharper than before. Finland has had protracted and increasingly large claims on the clearing account because it has not been possible to adjust exports rapidly enough when the value of imports has not reached the level set for it because of a fall in oil prices or a lower dollar exchange rate or both.

In the 1970s, the clearing account was in balance on average. But during the current decade, the situation has changed; Finland has had an almost permanent claim, averaging FIM 1.5 billion annually. The imbalances on the current account and clearing account have highlighted the importance of various financing arrangements in the 1980s in maintaining a measure of balance and a high level of trade.

On two occasions in the 1980s, Finland's claim exceeded the agreed credit limit to such an extent that the following financing and special measures had to be taken. In 1982 and 1987, some FIM 2.2 billion (SUR 300 million) was transferred as a credit from the non-interest bearing clearing account to a special interest-bearing account. In 1982-87, the Soviet Union delivered a total of over 10 million tonnes of crude to Finland for sale to third countries. The Soviet Union was paid for these deliveries through the clearing account while the earnings from the resale of crude were in convertible currencies. The advance payment system applied to vessels to be delivered to the Soviet Union has been gradually changed so that now vessels are paid for in full on delivery. This has made it possible to reduce Finland's claim and thus allow more time for the adjustment of Finnish exports. In spite of these measures, the clearing account balance has almost without exception remained above the agreed credit limit.

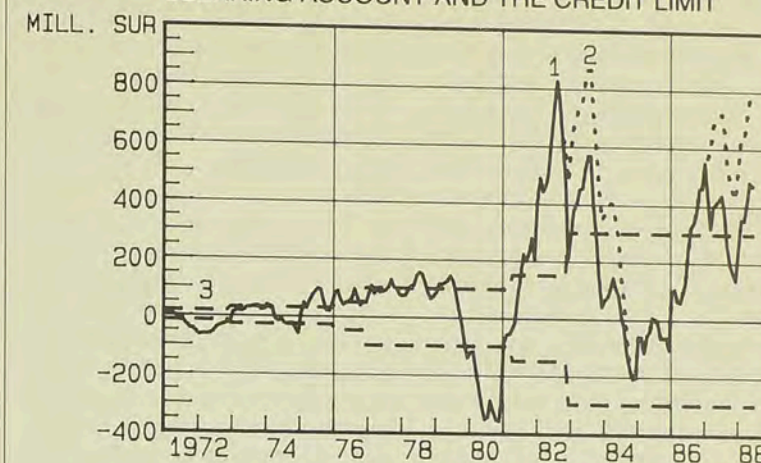
However, special measures may hamper the development of trade as in many cases they imply postponing the problem of the imbalance on the account until the future. The use of the rouble as the accounting and payment currency has also caused problems, relating to e.g. hedging the outstanding claim against exchange rate risks. The fact that credit cannot be extended by individual companies under the clearing system has been felt to be a problem, particularly by the Soviet Union, as, too, has the difficulty of incorporating new forms of trade, such as joint ventures, in the system. Indicative of the rigidity of the clearing payments system in recent years has been the fact that when Finland has had a claim on the account Finnish exports have had to be administratively restricted by licensing.

In September 1988, major changes were made to the principles applied in the system. As from the beginning of 1989, funds in the clearing account will be hedged against any changes in the external value of the rouble. Under the new agreement, the clearing system will be altered so that it will no longer be possible for long-term interest-free claims or liabilities to accumulate in the clearing account. As from the beginning of 1990, the credit limit in the clearing account will be lowered from the present SUR 300 million to SUR 200 million and any amounts exceeding this limit will be settled quarterly in convertible currency. The new credit limit will be interest-free up to SUR 100 million. The new agreement also enables the use of customary trade credits in Finnish exports to the Soviet Union.

OTHER COOPERATION

The 15-year comprehensive programme for technological development adopted by the CMEA in 1985 comprises five major areas of advanced technology. Many topics related to

CHART 4.
THE BALANCE ON THE FINNISH-SOVIET CLEARING ACCOUNT AND THE CREDIT LIMIT



1. Balance, monthly average (Jan. 1971 - June 1988)
 2. Balance, incl. special interest-bearing account (Nov. 1982 - Sept. 1984, Feb. 1987 - June 1988)
 3. Credit limit (Jan. 1971 - June 1988)
- Dec. 12, 1972/18
Dec. 13, 1972/30 →
Jan. 1, 1976/50 →
Dec. 22, 1976/100 →
Apr. 15, 1981/150 →
Dec. 15, 1982/300 →

the programme will also be discussed in connection with the cooperation between Finland and the CMEA, and thus Finland will have ample opportunities to make use of the CMEA's large potential for research. The CMEA is particularly interested in the capability of Finnish industry to quickly apply research results.

Finland has agreements on economic, technical and scientific cooperation with all Eastern European socialist countries. The forms of scientific-technical cooperation with the Soviet Union are well-established as it has been going on for almost 20 years in 35 working groups and under numerous separate agreements. The importance of cooperation for trade is growing as the structure of trade changes: the reaching of new deals increasingly requires knowledge of the other party's technical level and ability to ap-

ply the most advanced technology. The most important areas of cooperation are arctic research within the shipbuilding industry and measurement techniques and high-energy physics in science.

A standing Finnish-Soviet intergovernmental commission on economic cooperation was set up in 1967 to develop new forms of cooperation extending beyond the traditional exchange of goods. The commission investigates the development of economic contacts, draws up proposals for expanding commercial and other economic contacts, deals with issues related to the implementation of commercial and economic agreements, prepares proposals on the implementation of agreements and coordinates economic relations between the two countries. The long-term programme signed in 1977 and the monitoring of its

implementation are also the responsibility of the commission.

Industrial cooperation aims at expanding trade in machinery and equipment between the two countries. Its share in the exports of the Finnish metal and engineering industries has risen so that almost half the exports of machinery and equipment to the Soviet Union is now based on industrial cooperation. The establishment of joint ventures aims at the joint production of goods for sale in the markets of third countries. There has been keen interest in joint ventures but so far only a few joint ventures involving Finnish companies have been registered in the Soviet Union. They comprise both service and manufacturing companies.

FUTURE PROSPECTS

A more favourable setting was created for the expansion of economic cooperation between European countries with different political systems when in June of this year the CMEA and the EC signed an agreement on establishing diplomatic relations after 15 years of negotiations. At the same time, it was agreed that individual CMEA countries decide on their relations with the EC on a bilateral basis. Thus each CMEA country has the chance to give diplomatic recognition to the EC and to conclude its own agreements, with potentially significant economic implications.

The economic reforms now under way in the CMEA countries are increasing the direct operating scope of companies in these countries, e.g. in foreign trade. However, the implementation of administrative changes in foreign trade are slow since they require the implementation of reforms in other areas. For instance, the aim is that in 1988-89 all Soviet enterprises should become fully accountable for their financial performance and that changes in e.g. the planning, pricing,

financing and wholesale trade systems be implemented by the beginning of the next five-year term, i.e. by 1991. However, this time horizon seems rather short and it is more realistic to assume that these new forms of operation become established only gradually, later in the 1990s.

The bilateral clearing system has been well-suited to the centralized and planned foreign trade system of the Soviet Union. Its advantages will change substantially at the latest in the event that the rouble becomes a convertible currency, which may happen as a result of the reforms. If the next five-year plan for the Soviet economy and the foreign trade plans, in particular, are formulated in more general terms than before, it will naturally affect the structure and detailedness of the framework agreements between Finland and the Soviet Union. It is possible that the framework agreement will become a document laying down

general guidelines, which in turn would influence the nature of annual protocols on the exchange of goods.

The amendments endow the payments system with the desired flexibility and will facilitate the introduction of new, more sophisticated forms of trade. Automatic settlement in convertible currencies is likely to lead to trade with Finland being conducted more in line with that of other western countries in the Soviet foreign currency planning system. This may entail an expansion of the choice of goods offered by the Soviet Union to Finland. On the other hand, Finnish exports may have to face fiercer competition as they will be compared more closely with imports from other western countries. In any case, it is quite clear that the mechanism determining trade is going to change.

November 4, 1988

FINLAND'S COMMERCIAL RELATIONS WITH DEVELOPING COUNTRIES

by **Alec Aalto**, Deputy Director General
Ministry for Foreign Affairs

When examining Finland's external economic relations, the developing countries, or LDCs (less developed countries), are normally taken to be those countries which are not members of the OECD or the CMEA. Our knowledge of the developing world is, on the whole, limited and of recent origin. Trade and tourism are phenomena of the last few decades, and Finland has neither the historical relationships nor the geographical proximity to create a special awareness of any particular developing country.

It is probably true to say that Finland has been equally unknown to the developing countries. The impact of Finnish development assistance or peacekeeping forces is rather limited in this respect. Being a member of EFTA or one of the neutral countries of Europe does not carry much weight when trying to promote Finnish trade in the Third World. The Scandinavian connection may, incidentally, have a better reference value in some parts of the world.

There are instances when a company from a small, non-aligned nation is preferred to a multinational as a supplier of goods or know-how. But, though a colonial past can be a political handicap for a country, it can often be turned into a commercial advantage for its companies, when there is a common language, uniform standards and long-established administrative and trading ties. A small, newly-internationalized country like Finland has few initial advantages when entering untried, far-off markets.

Given the heterogeneity of the developing world and the fact that trade relations between Finland and a large number of LDCs are non-existent, it could be argued that this aspect of Finland's external economic relations is no more than just a number of individual cases. Our economic cooperation with the developing world lacks uniform structures such as the OECD framework, the free trade arrangements in Western Europe and — though less uniform — the trading arrangements with the socialist countries of Europe. However, certain unifying features have been emerging during the last two decades. The system of Generalized Specialized Preferences (GSP), which favours imports from developing countries, is slowly expanding. Various financial mechanisms for promoting Finnish exports and investments have

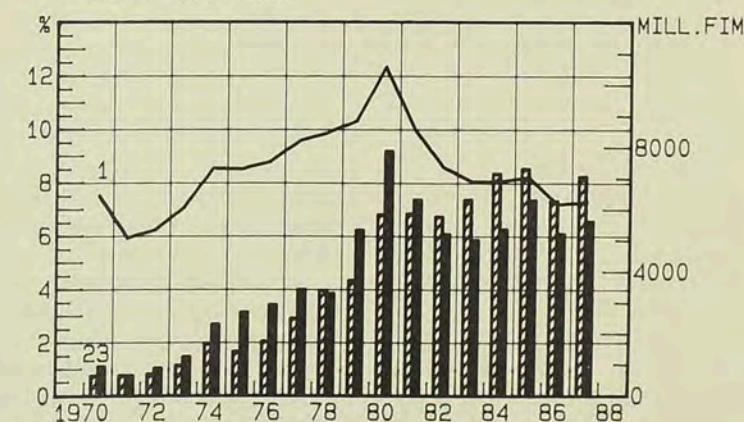
recently been created. A standard type of agreement on economic and industrial cooperation is in force between Finland and nearly thirty developing countries.

TRADE IN GOODS

The LDCs' share of world trade is around 20 per cent, of which two-thirds is carried on with the OECD countries. Trade with LDCs makes up about 20 per cent of the total trade of the OECD countries. In Finland's case, the corresponding figure has been noticeably lower, in recent years well below 10 per cent (Chart 1). Imports from LDCs peaked in 1980 at 13.6 per cent of total imports, while exports have only rarely exceeded the 10 per cent level.

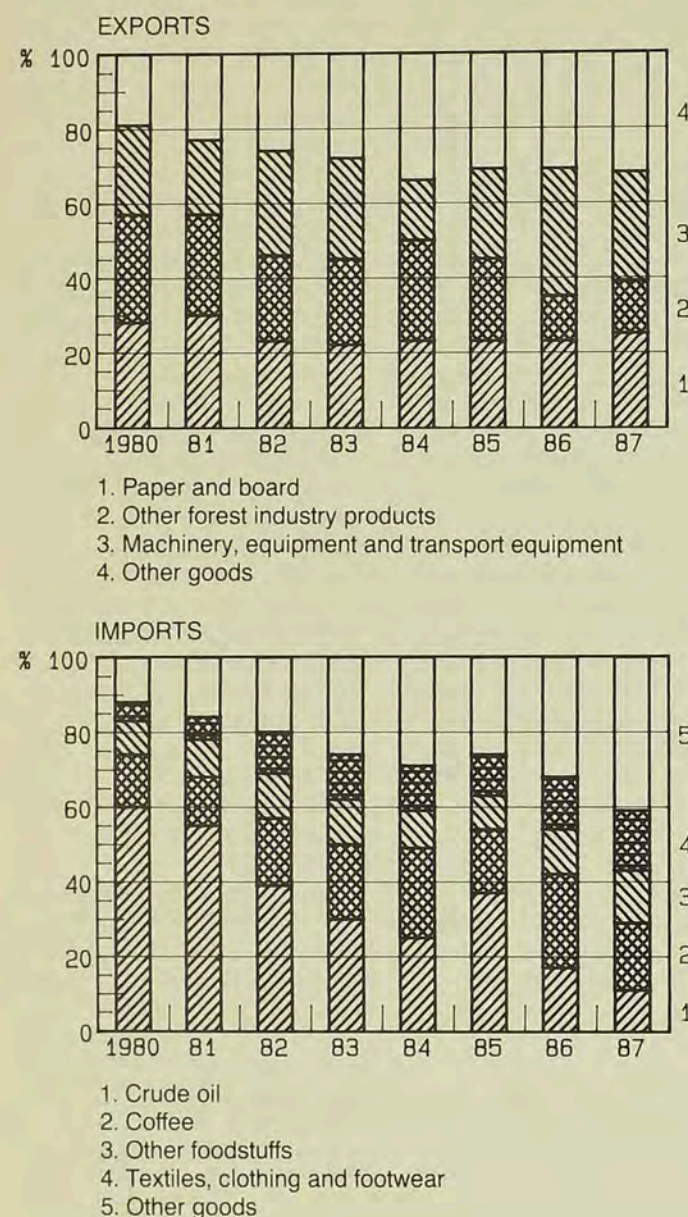
Taking into account the fluctuations in the prices of oil and coffee, the two single most important items in Finnish imports

CHART 1.
FINLAND'S TRADE WITH DEVELOPING COUNTRIES IN 1970 - 1987



1. As a percentage of Finland's total trade (left scale)
2. Exports in mill. FIM (right scale)
3. Imports in mill. FIM (right scale)

CHART 2.
COMPOSITION OF FINLAND'S TRADE WITH DEVELOPING COUNTRIES IN 1980 - 1987 BY MAIN CATEGORY OF GOODS, PERCENTAGE SHARES



from developing countries, trade both in value and particularly volume terms has in fact been rather stable over the last decades.

The share of exports to LDCs in Finland's total exports was around 6 per cent in the late 1960s, gradually rose to a record high of 10 per cent in 1980 and then fell slowly to 8 per cent in 1987. The value of annual ex-

ports has decreased only three times over the last twenty-five years.

The share of imports from LDCs in Finland's total imports has been more volatile because of sharp variations in commodity prices. After displaying a slowly rising trend in the 1960s, it grew at an accelerating pace in the 1970s and peaked in 1980.

On the whole, it would seem that changes in the structure and geographical distribution of both imports and exports in the last decade have been greater than those in the aggregate figures for trade with LDCs.

Exports

Forest industry products have traditionally dominated Finland's exports to developing countries in both North Africa and Latin America. In the 1980s, however, their share has been declining, and the volume of exports has fallen considerably.

The share of metal and engineering industry products has fluctuated between one-quarter and one-third of total exports (Chart 2). Important products include forest industry machinery and machinery and equipment for power generating and transmission. Telecommunications is a rapidly growing export sector.

The export figures have occasionally been inflated by sales of second-hand ships and the transfer of Finnish ships to open registers in certain small developing countries.

Other exports include chemicals, whose share has been steadily growing, and furs, especially to Asian countries.

Imports

While it is difficult to discern any clear trends in Finnish exports, such trends are easily observable on the import side. The combined share of crude oil and coffee is today less than half of that a few years ago. While the volume of imported coffee has remained stable over the years, that of oil has declined rapidly as a result of reduced reliance on oil as an energy source and changes in the supply structure (Chart 2). Most of the country's oil requirements are covered by imports from the Soviet Union, trade with which is conducted on a bilateral basis.

Traditional imports from developing countries of tropical

fruit and other foodstuffs have not changed much in recent years. On the other hand, both textiles and footwear have been growing rapidly, as, too, have several other categories of finished goods, such as office equipment, audiovisual equipment and other electronics.

The established view of LDCs as exporters of primary commodities with only a limited supply of marketable industrial goods no longer holds true in Finland's case, if imports from these countries are viewed as a whole. However, the benefits of the changes in the structure of imports are unevenly spread. A few newly-industrializing economies (NIEs) in Asia have established themselves in the rapidly expanding market for finished consumer goods, while a growing number of countries are still competing for a share of the less promising market for foodstuffs and cheap textiles.

Trading partners

The changing pattern of trade is strongly reflected in the figures for individual trading partners. The OPEC countries accounted for 60 per cent of Finland's imports from the developing world in 1980, virtually all of their share consisting of oil. Seven years later OPEC oil, originating entirely from Saudi Arabia, accounted for less than 15 per cent. As Finnish companies succeeded in establishing themselves as major suppliers of goods and services to the booming Arab market, the large deficit of 1980 soon turned into a substantial surplus. Falling oil prices and the Gulf War then sharply reduced the overall volume of trade. Trade balances with individual Arab OPEC countries have fluctuated considerably.

The expanding share of industrial goods in Finland's imports from developing countries is reflected in the trade figures for the four NIEs of Asia. In 1980, Hong Kong, the Republic of Korea, Singapore and Taiwan accounted for 6 per cent of imports from LDCs,

while in 1987 their share had risen to 28 per cent (Table 1). In this case, trade has developed in a fairly balanced fashion: while Finland's exports to these countries were virtually nil in 1980 they had risen to one-fifth of all of her exports to developing countries in 1987.

TABLE 1. FINLAND'S FOREIGN TRADE WITH DEVELOPING COUNTRIES: TOP TWELVE

IMPORTS		
Share of total imports from developing countries, per cent		
	1987	1980
Saudi Arabia	12.5	36.6
Republic of Korea	9.9	1.8
Brazil	8.9	5.0
Hong Kong	8.1	2.5
China	8.0	1.4
Taiwan	7.8	0.6
Colombia	6.3	5.6
Costa Rica	3.2	2.3
Singapore	2.3	0.6
Thailand	2.3	0.5
Morocco	2.1	0.9
Malaysia	2.1	0.8

EXPORTS		
Share of total exports to developing countries, per cent		
	1987	1980
China	9.8	5.1
Republic of Korea	7.9	0.6
Egypt	7.0	6.4
Saudi Arabia	6.0	5.3
Hong Kong	5.4	0.8
India	4.3	2.4
Algeria	4.1	5.8
Taiwan	3.5	0.3
Singapore	3.4	1.2
Brazil	3.4	3.6
Indonesia	3.0	1.6
British Territories in the West Indies	2.9	0.2

The three main suppliers of coffee to the Finnish market, Brazil, Colombia and Costa Rica, have each run a consistent surplus in their trade with Finland. In Latin America, only Brazil is currently a major market for Finnish exports.

As regards trade with other developing countries, Finland tends to be in surplus rather than in deficit. Normally Finnish exports consist of forest industry products or investment goods, which, in practice, are difficult to match with supplies of tropical agricultural products, textiles, leather goods and handicrafts. As an adherent to the principle of free trade and with a strongly market-oriented economy, Finland has been neither able nor willing to accept demands for cutting trade surpluses through state interference. Equally, Finland

has accepted huge deficits, e.g. with oil and coffee producers, and called for stronger marketing efforts to reduce the deficits by increasing Finnish exports.

A special trading situation is created where trade is generated by official development assistance (ODA).¹ Bilateral aid accounts for 60 per cent and multilateral aid for 40 per cent of total Finnish ODA. The vast bulk of Finnish bilateral aid is channelled to a number of Sub-Saharan states and a few countries in Asia. Several of these are among the least developed countries (LLDCs). Since well over half of all Finnish ODA is spent on supplies of Finnish goods and services, it is obvious that this has a significant effect on the overall export figures and especially on the trade balance of the main recipients of aid. Incidentally, this also affects any analysis of the economics of trade with LDCs.

TRADE IN SERVICES

Construction and consulting activities played an important role for some years in Finland's economic relations with the developing world. The cycle was short but intense. Construction projects in developing countries, mainly in the Middle East, amounted to over FIM 2.5 billion in 1982, i.e. over 60 per cent of total exports in this sector (Table 2). Last year, the corresponding figures were some FIM 300 million and 15 per cent. Facing increased competition from Far Eastern countries with cheaper labour and the growth of a domestic construction industry in many developing countries, Finnish builders can offer specialized techniques and project management, involving a minimum of Finnish personnel on the spot. Hotels and residential areas for tourism is a potential new market.

¹ For a more detailed discussion of ODA, see the article "Finland's Development Cooperation in Support of Structural Adjustment" by Kai Helenius in the November 1987 issue of the Bank of Finland Monthly Bulletin.

TABLE 2. FOREIGN INVOICING OF FINNISH CONTRACTORS IN 1980 — 1987, MILLION FIM

	1980	1981	1982	1983	1984	1985	1986	1987	Total 1980—1987
Soviet Union	1 290	1 250	1 600	2 730	1 980	1 330	1 290	1 514	12 984
Other CMEA countries	98	8	8	25	30	20	5	15	209
Western Europe and USA	68	48	37	60	83	130	80	174	680
Middle East	776	1 702	2 462	1 085	845	650	315	144	7 979
Central Africa	61	137	152	195	100	110	115	86	956
Far East	10	53	54	27	4	24	95	72	339
TOTAL (approx.)	2 300	3 200	4 300	4 100	3 050	2 250	1 900	2 000	23 150
of which developing countries	847	1 892	2 668	1 307	949	784	525	302	9 274
%	(37)	(59)	(62)	(32)	(31)	(35)	(28)	(15)	(40)

Consulting services to LDCs accounted for close to 60 per cent of all exports in this sector in 1981, while the corresponding figure for last year was only 30 per cent (Table 3). Activities are down to a minimum in the Middle East and have been falling in Africa as well. The Far East, by contrast, seems to be an expanding market. There is growing reliance on development assistance programmes, which, in fact, financed more than half of consulting services to LDCs last year. With the decline in construction exports, consultants are concentrating on other sectors such as forestry, energy, environmental services and specialized services for the public sector.

The economic importance of the service sector is difficult to assess for many reasons. Export figures can easily be misleading, as part of the expenses are local costs. Nonetheless, it is obvious that construction and consulting activities have directly created export opportunities for Finnish goods, increased the awareness of Finland as an advanced nation

with a highly skilled workforce and provided many Finns with useful experience of working abroad.

Other services play a minor role and statistics are not readily available. Tourism is naturally a source of growing surplus for certain developing countries, and this has to be borne in mind when examining their deficits on the trade side.

THE PROMOTING AND FINANCING OF EXPORTS

The setting of priorities

Opening up new markets in the developing world requires close interplay between the business community, financial institutions and government. Normally, company interests are the guiding factor, but the assessment of commercial opportunities is often based on information provided by embassies, The Finnish Foreign Trade Association and official financial institutions. Sometimes the authorities may try to stimulate interest in a market where short-term business prospects would

not seem a sufficient reason for individual companies to establish or maintain a presence.

The point of departure is whether a given country has a market for those rather specialized goods and services which Finland can competitively provide. Other factors are overall economic performance, creditworthiness, payment record and regulations relating to trade, investments and foreign companies.

Annual priorities are set on the basis of economic and political indicators and surveys of business interests. These are translated into concrete proposals for high level visits, meetings of joint economic commissions, participation in international fairs, bilateral symposia etc.

Selectivity is today's watchword. With the increased internationalization of Finnish business, there is a more realistic and precise view of where commercial opportunities lie. Accordingly, there is less need for general exploratory missions. Official efforts are concentrated on fewer countries than before, mainly in the Gulf region and the Far East. Selectivity must not mean neglect of those traditional markets where prospects are temporarily less promising, though in recent years promotional activities in e.g. Latin America and Africa have, on the whole, been less frequent and more closely tied to concrete projects than before.

The debt situation

The worsening debt situation of the developing world does not necessarily imply a reduction in the volume of trade. Some of the big debtors are huge economies, in which Finland's share of external trade is 0.2—0.3 per cent. In markets where Finnish paper or specialized high-tech goods are attractive, finance need not be a problem. In the case of weaker economies, however, development assistance becomes virtually the only source of finance. Since Finland's as-

sistance focuses on a few countries, the debt problem precludes trade with a large number of LDCs.

Where economic risks are considerable, export guarantees are essential for economic cooperation. Less than one-fifth of all exports of goods to LDCs are covered by official export guarantees. This probably reflects the composition of Finnish exports, a large portion of which consists of non-investment goods with short terms of payment. Most investment goods and projects as well as most exports to high-risk countries are covered. It would also seem that only a few of the countries worst hit by the debt crisis have been significant export markets for Finland.

Finland participates in the activities of the Paris Club and has entered into several agreements on the rescheduling of debts.

There have been relatively few disputes concerning receivables of individual companies covered by export guarantees and only a small number of countries have been involved. The problem is not negligible, however, given the modest size of the Finnish companies involved and of overall trade with LDCs.

The risk-taking capacity of the export guarantee system is a determining factor when trying to diversify exports and markets. More demanding projects and potentially lucrative markets may remain out of reach, if too narrow limits are placed on the availability of guarantees. Some special arrangements for LDCs may be called for, especially as the newly-created system of concessional credits is likely to put considerable strains on the guarantee system.

Financing

Trade with developing countries is normally financed on commercial terms. There are no governmental agreements on bilateral trade, and private barter deals are very much the

exception. The terms of export credits are determined on an OECD consensus basis. Subsidies cannot form a lasting basis for economically viable trade.

In spite of the view that trade and aid are separate activities, the Government — like its counterparts in other OECD countries — has seen the need for a facility to support export credits for projects and programmes with a high development effect. This concessional credit scheme, in operation since 1987, follows the rules laid down within the OECD. Interest in the scheme has been considerable; to date there have been over 100 applications involving projects in 27 countries, normally low or middle-income economies, and with a total volume of more than FIM 3 billion. The scheme is administered by Finnish Export Credit Ltd and FINNIDA, while the final decision on the interest subsidy is taken by the Government. So far, only a few decisions have been taken, and a large number of applications will probably never reach the commercial stage, as most projects concerned are internationally tendered. The scheme will have to be continuously improved in order to meet both development and commercial requirements.

Barter deals are often advocated as a means of promoting Finnish exports where the payments situation is difficult or where there is a serious imbalance in trade. The official line is that such deals have a distorting effect on trade and national economies in the long run and that there is no mandate for a government in a market economy to enter into such transactions. With these reservations in mind, it can be noted that barter trade accounts for the bulk of one country's trade with Finland while in some other instances barter has been a necessary condition for important projects. On the whole, however, the volume of barter trade is modest, and experience of it is limited.

International development

institutions and banks provide opportunities for project exports, information on which is channelled to companies through embassies and The Finnish Foreign Trade Association. Participation in World Bank projects has lately been on the increase. Contacts between companies and regional development institutions, e.g. the Asian Development Bank, are being actively promoted.

Contacts with national financial and investment institutions, particularly in the Arab world, have recently been established with a view to exploring the possibilities of joint projects in third countries. Both these and other ideas for promoting cooperation in third countries are frequently discussed at meetings of joint economic commissions, but it seems difficult to find concrete ways of implementing them. Some useful experience has been gained through the activities of the Nordic Investment Bank, which provides finance for projects with a multi-Nordic content in developing countries.

INVESTMENTS AND ESTABLISHMENT

Finnish direct investment abroad has been growing rapidly in the 1980s. In recent years, many important developing countries have opened their economies to foreign investment with a view to stimulating technology transfer or simply providing employment through joint ventures or wholly-owned subsidiaries. Some Finnish investment in LDCs has taken place, but the attraction is modest compared with establishing in the EC or the US (Table 4). Manufacturing units are still rare, which indicates that the transfer of technology is on a narrow basis (Table 5). Only in Brazil, India, Saudi Arabia, Singapore and Malaysia are four or more Finnish manufacturing units to be found.

A government agency for stimulating investment in LDCs, FINNFUND, was set up in 1979.

TABLE 3. EXPORTS OF CONSULTING SERVICES IN 1981 — 1987, BY REGION, PERCENTAGE SHARES

	1981	1982	1983	1984	1985	1986	1987
Soviet Union	17.3	25.9	22.2	12.3	21.9	26.6	19.7
Other CMEA countries	0.2	0.8	1.3	1.1	0.7	1.0	0.2
Western Europe	22.2	19.2	20.7	33.3	40.5	35.4	45.4
Middle East	22.4	21.4	13.5	9.8	10.1	3.4	1.9
Africa	27.8	25.7	34.0	30.1	11.2	16.3	15.3
North America	2.4	1.0	0.7	3.3	4.5	5.8	4.4
Central and Latin America	0.7	1.2	1.5	1.0	1.2	0.8	0.8
Far East	7.0	4.8	6.1	9.1	9.9	10.7	12.3
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0
of which developing countries	57.9	53.1	55.1	50.0	32.4	31.2	30.3

MEMORANDUM ITEM
TOTAL in FIM MILL.

	364	444	414	417	463	455	510
--	-----	-----	-----	-----	-----	-----	-----

TABLE 4. NET INVESTMENT BY FINNISH COMPANIES IN SUBSIDIARIES AND ASSOCIATES ABROAD IN 1980 — 1987, MILLION FIM

	1980	1981	1982	1983	1984	1985	1986	1987
EFTA	76	167	263	138	1 351	371	1 723	686
EEC	148	256	430	598	654	817	1 326	2 385
North America	161	112	289	606	286	659	334	474
Developing countries	77	52	97	94	179	160	227	115
Other	25	25	46	15	9	69	31	126
TOTAL	487	612	1 125	1 451	2 479	2 076	3 641	3 786

At the end of last year, FINNFUND had investments totalling FIM 167 million in 23 projects in 16 countries. Participation by FINNFUND requires a Finnish and local partner and takes the form of equity holdings and loans.

Problems encountered in joint venture activities include difficulties in assessing risks and profitability, meeting managerial requirements and training needs, and finding a suitable local partner. This is why government-to-government discussions on the need to promote investment seldom lead to concrete results, unless there are direct business interests involved.

IMPORT ARRANGEMENTS

There is a strong government interest in promoting imports from LDCs. In the Finnish economic system, this cannot be done through interference in commercial activities or through government purchases. One means is the advice and assistance provided to exporters of LDCs by the government sponsored PRODEC (Program for Development Cooperation). This presupposes a willingness on the part of the exporter to make a marketing effort. Such a willingness is often lacking in spite of official efforts to increase trade, mainly because Finland is a small and unknown market.

TABLE 5. TOTAL NUMBER OF FINNISH SUBSIDIARIES AND ASSOCIATES ABROAD AS AT DECEMBER 31, 1987, BY SECTOR¹

	Manufacturing	Sales	Financing and insurance ²	Other	Total
EFTA	114	412	9	174	709
EEC	149	460	31	248	888
Developing countries	46	78	25	91	240
Others, total	79	172	17	135	403
GRAND TOTAL	388	1 122	82	648	2 240

¹ Sector of subsidiary or associate
² Incl. banks' branch offices

This, incidentally, explains why a considerable proportion of imports reach Finland through third countries.

Another means of import promotion is the GSP system, in force since 1972 and today covering virtually all LDCs. All industrial products are included, with the exception of certain sensitive products, e.g. textiles. Agricultural coverage is more restricted the aim being to safeguard domestic farming. The preferences have been expanded to some extent over the years, with special concessions for the LLDCs. The rate of utilization is high and there are no quotas or other restrictions involved.

The developing countries as a group naturally benefit most from those preferences which give them a competitive advantage in relation to industrialized countries, i.e. in industrial goods rather than in tropical products. It is not surprising that the biggest beneficiary is the Republic of Korea, followed by Hong Kong.

The one notable exception from the industrial coverage of the GSP system is textiles. Finland applies comparatively high duties on garments and has concluded agreements under the multi-fibre arrangement (MFA) with the most important suppliers to the Finnish market. These agreements are generally regarded as reasonably

liberal both in coverage and quotas, and textile imports from LDCs have been steadily growing. From the trade point of view the quotas have probably had the effect of diverting trade from certain efficient Asian producers to countries within the European free trade system. On the other hand it is highly doubtful whether doing away with all restrictions, including duties, would benefit a wider group of developing countries. The net result might be an increased flow of even cheaper textiles from the biggest and most efficient producers.

COOPERATION AT GOVERNMENT LEVEL

The influence of the state is present at all levels of economic activity in most developing countries. Most forms of economic cooperation thus require the active or tacit support of governmental authorities, at least in the initial stage of opening a new market. Contacts at government level primarily serve to explore opportunities and identify public and private parties interested in future cooperation. At a later stage, joint government efforts may be needed to eliminate obstacles and make shortcuts where private business finds it difficult to proceed. The standard vehicle for joint action by governments is an agreement on economic, industrial and technological cooperation (EIT).

An EIT agreement provides a framework for economic cooperation. It states the intention of the two governments to initiate and pursue cooperation in various fields and sets up a joint commission for the implementation of these intentions. Depending on the role of the administration in the other country and on prevailing economic conditions, such an agreement can, from Finland's point of view, be a necessity, a useful channel or a dormant resource. The network of EIT agreements covers virtually all of Finland's present or potential

export markets (Table 6). Most agreements have proved fruitful. Joint commissions have identified areas — sometimes even concrete projects — of common interest, cleared up problems concerning trade and payments and opened doors for the business community in both countries.

With the increased emphasis on the role of the private sector in most LDCs, the traditional type of regular meetings between high officials in joint commissions may have outlived its usefulness. Increased direct involvement of enterprises, permanent specialized working groups and joint studies of investment opportunities are methods that are being tried out in order to revitalize the work.

Special EIT grants have been available since 1984 as "seed money" for promising projects of Finnish firms. The money can be used for feasibility studies and training purposes primarily within the framework of EIT agreements. To date some FIM 28 million has been made available for a total of 90 projects in more than 20 countries. Matching funds are provided by the Finnish firms and their counterparts in the country involved. The largest number of projects have been in China, Malaysia, Indonesia and Colombia.

Besides the EIT network, there are numerous agreements on air transport, road transport and taxation. A few agreements on the protection of investments have recently been concluded and Finland has signed the convention on the Multilateral Investment Guarantee Agency. With the increased emphasis on joint ventures, this may be an important development, and it is worth noting that the opportunities for foreign investment in Finnish companies have been enlarged as well.

PROSPECTS

Outlining the prospects for trade with LDCs calls for

TABLE 6. FINLAND'S AGREEMENTS ON ECONOMIC, INDUSTRIAL AND TECHNOLOGICAL COOPERATION WITH DEVELOPING COUNTRIES

		Year of agreement	Number of joint commission meetings
ASIA	China	1979/1987	6
	India	1974	6
	Indonesia	1987	1
	Iraq	1964	12
	Republic of Korea	1979	4
	Kuwait	1980	3
	Malaysia	1980	3
	Saudi Arabia	1976	9
	Thailand	1988	—
	United Arab Emirates	1982	2
AFRICA	Algeria	1982	1
	Egypt	1977	7
	Cameroon	1988	—
	Libya	1980	5
	Morocco	1979	2
	Nigeria	1981	1
	Senegal	1987	—
	Sudan	1980	1
	Tunisia	1965	—
LATIN AMERICA	Argentina	1980	2
	Brazil	1981	2
	Colombia	1980	3
	Mexico	1975	6
	Peru	1965	—
	Venezuela	1979	1

N.B. Agreements with Iran and Jordan are under preparation

sweeping generalizations, which will not necessarily be applicable in any individual case. A considerable number of developing countries will continue to be dependent on ODA to finance vital imports. A few newly-industrialized countries will be gradually integrated into the circle of industrialized market economies. In between there lie small but wealthy nations, huge economies with low per capita income, and middle-sized economies with good potential. Commercial prospects are often promising, but, because of political and economic conditions, not necessarily stable.

In Finland, the business community and the authorities are by now reasonably well acquainted with the markets of the developing world. Exploiting their potential should be based on selectivity in the choice of markets, perseverance in marketing efforts and deeper local involvement. The heavy costs involved normally limit participation to the big exporting companies or to smaller internationally specialized firms.

Most developing economies are becoming more market-oriented, with increasing reliance on private busi-

ness. Transfer of technology, a local partnership and direct investment may be necessary preconditions for a long-term presence in a market.

Local production based on Finnish know-how and machinery can result in products better suited to LDCs than certain traditional Finnish exports, in cases where the quality/price ratio is more geared to the demands of OECD markets.

Finance is readily available, but there is a need for more risk-taking and for less subsidies, if this can be agreed upon internationally.

Raising the developing countries' share of our total trade is no end in itself. Whose share should be correspondingly reduced? But a healthy, growing commercial relationship is a vital element in our relations with the developing world and an integral part of the internationalization of Finnish business and industry.

November 1, 1988

HIGH TECHNOLOGY IN FINNISH FOREIGN TRADE

by **Harri Luukkanen**, Research Manager
Teräs-Kari Oy Consulting

This article starts by reviewing international trends in high technology. It then goes on to examine the impact of high technology on structural change in the engineering industry and, in particular, the importance of high technology for Finland's foreign trade. Finally, the article considers the implications of technological progress in the European Community, the USA and Japan for Finnish export markets and technology imports.

Over the last 15–20 years, a number of product groups have appeared in international markets which have been characterized by high dependence on research and development, long lead times between basic research and the final product and rapid obsolescence because of competition from new products. In addition, these products, referred to as high-tech products, typically require large investments in production and marketing.

According to the definition of an OECD working group, high-tech products include numerically controlled machine tools, industrial robots, telecommunications electronics, industrial automation and measuring equipment, fibre optics, ADP equipment, microelectronics, medical devices, space technology and biotechnology.

Other definitions, e.g. the DOC2 list of the US Department of Commerce, have a wider coverage, embracing a large number of other technology-intensive product groups. Generally speaking, it is difficult to make a statistical classification of high technology because product definitions are tied to time and the prevailing level of technology.

Because the competitiveness of productive activities in industrial countries relies increasingly on the use of high-tech products, these products are of great strategic importance to the governments and economies of these countries. Common to most high-tech products is that they are manufactured in the engineering industry and are highly dependent on advances in microelectronics and computer technology. Whereas formerly advances and manufacture in high technology focused on hardware, today the emphasis is on software. Associated with this has been an increase in the intelligence embodied in products.

These product groups are discussed below. Space technology, biotechnology and microelectronics are not dealt with, however, because of the rather specialized nature of these product segments.

DEVELOPMENTS IN INTERNATIONAL MARKETS

In 1970–1985, demand for high-tech products in the OECD countries grew at an average annual rate of 18 per cent, measured at current prices in US dollars. This is 3–4 times faster than the growth of GDP during the same period. The main contribution to the vigorous growth of demand and production has come from computer sales, which account for approximately half of the market for high-tech products. Growth in another major product group, telecommunications electronics, has been slower than the average growth rate over the long term.

In 1985, the total market for high-tech products in OECD countries amounted to an estimated USD 225 billion, and the governments of these countries are understandably showing an interest in the promotion of these industries. Companies which failed to perceive the changes that occurred in their environment or sector in the 1970s fell by the wayside in the new decade. Technological change became the goal of all industrialized countries, the doctrine anchored in research and technology policy and, more widely, the basis for economic growth and competitiveness.

However, the high-tech market has changed rapidly since the mid-1980s. In most sectors, rapid growth of demand has given way to overproduction and slower, cyclical growth. This reflects the maturity of the major part of high-tech products and the gradual saturation of markets. Manufacturing know-how has been transferred to a large number of companies and to many countries. Several product groups are already losing the dynamism which distinguished them earlier. Evidence of this is to be found both in markets and technological change.

MARKETS AND TECHNOLOGICAL CHANGE

For instance in the computer market, the growth trend of demand seems to have slowed down permanently since 1985, most notably in the USA but also in other industrialized countries. Cyclical fluctuations in demand are becoming more pronounced and markets are gradually being saturated in

several application areas. Cheap microcomputers and programs have decentralized data processing and won a major share of the market. The costs of minicomputer and mainframe computer programs and slow growth in the productivity of programming have accelerated the shift to microcomputers.

Similarly, the use of industrial robots is no longer increasing to any significant degree in traditional applications, and the mass market predicted at the beginning of the decade has not materialized. The hopes placed in new applications and more advanced robots have largely been unfulfilled. In 1987, sales of robots in OECD countries amounted to 37 000 units, which meant a halt in the growth of sales. The introduction of robots has encountered difficulties mainly in the US market.

In process automation, replacement investment has been the key factor underlying the demand for digital automation systems since the mid-1970s. Now the market for investment goods replacing old analog systems has almost been exploited to the full and construction of new process plants is slowing down throughout the world. The pace of technical change is more even than before and requires greater resource inputs than in the breakthrough phase.

In the OECD countries, 50 per cent of metal machine tools acquired (calculated at acquisition cost) are numerically controlled and thus established technology. In 1985, the number of NC machine tools manufactured in the OECD area amounted to some 74 000 units, and this amount is unlikely to have risen in subsequent years. The penetration of NC machines and the increase in the number of installed units from the estimated 650 000 units in 1987 are likely to be fairly slow in the future. The trend will continue to be towards flexible manufacturing systems but

it is likely to proceed slowly.

Telecommunications faces the prospect of expanding markets on two fronts. First, technological change will lead to the replacement of old analog technology with new digital technology. Secondly, new services will become available and this is estimated to result in a doubling in the number of public telecommunications services by the year 2000 from about 15 at present. The digitalization of telephone exchanges, transmission links and private branch exchanges (PBXs) will also be necessary for the extension of new services to homes and workplaces.

The world's first fibre optics based transmission links were connected to the public telephone networks in Finland and Canada in 1979. Five years later, there was a transmission network of some half a million fibre kilometres stretching all over the world. Now optical cables are replacing copper, compete efficiently with satellite links and extend across continents and under oceans.

Since the early 1980s, demand for medical devices has been held in check by slow economic growth and efforts to curb public expenditure. A comprehensive network of health services was created in the previous decade, and the main need now is only for replacement investments. As far as medical equipment is concerned, technical change continues: film-based X-ray equipment is being replaced by digital equipment and new technologies, such as ultrasound and magnetic resonance imaging, are becoming increasingly important. The demand for electromedical instruments and laser instruments of various kinds is also expected to increase.

According to the latest studies, the rate of growth in the total demand for high-tech products in the OECD area is likely to fall by a half in the 1990s from the high growth figures of

the early 1980s. Growth in the computer market is expected to follow this overall trend.

STRUCTURAL CHANGE IN THE FINNISH MARKET

These international trends also provide the background for the development of high technology in Finland. Changes in the commodity composition of production and exports are closely linked to three basic factors: exports to market economies, expansion of the production of the engineering industry and vigorous international demand for new products.

These longer-term trends can be discerned in Table 1. The production and exports of high-tech products have grown rapidly, particularly in the 1980s. In addition, the share of high-tech products in the production and exports of the engineering industry has grown considerably.

In 1985, the value of high-technology production amounted to FIM 5.7 billion and that of exports to FIM 2.9 billion; at the same time, high-tech products accounted for 12.4 per cent of the output and 12 per cent of the exports of the engineering industry. At present, the value of high-technology production exceeds that of shipbuilding or wood processing machines, two relevant yardsticks in Finland.

The growth of high-tech and other engineering exports to western markets has led to a marked increase in production. In 1970–85, the volume of production of the engineering industry in Finland grew by 5.5 per cent a year on average, substantially faster than the 3 per cent average annual growth rate recorded for the OECD countries as a whole.

Some Finnish high-tech products, such as measurement and control instruments, data transmission equipment and electrical medical equipment, trace their origins to the

TABLE 1. THE HIGH-TECH INDUSTRY IN FINLAND IN 1970, 1975, 1980 AND 1985^{1, 2}

A. Gross value of high-tech production, imports, exports and domestic sales, FIM million

	Production	Imports	Exports	Domestic sales
1970	177	327	66	438
1975	641	825	235	1 231
1980	1 731	1 760	870	2 621
1985	5 707	4 239	2 929	7 017

B. The share of high-tech products of the engineering industry (ISIC 38) in production, imports, exports and local domestic sales, per cent of gross value

	Production	Imports	Exports	Domestic sales
1970	2.7	7.7	3.6	5.1
1975	3.6	7.5	4.4	5.5
1980	5.5	10.4	8.9	6.7
1985	12.4	14.7	12.0	13.9

¹ High-tech products include the following items: numerically controlled (NC) machine tools; industrial robots; telecommunications equipment excl. cables; fibre optics; industrial automation and measuring equipment; ADP equipment and parts; and medical, electromedical and analytical instruments.

² Approximate figures.

1960s. They were followed by the products of the 1970s — computers, industrial robots and CNC machine tools. Fibre optics, space technology and microelectronics are the products of the 1980s in Finland.

Many high-tech products have been commercially successful. Success has almost invariably been achieved in export markets because the domestic market is too small to sustain profitable production. Moreover, success has been attained under truly competitive conditions as the domestic market is fully open to foreign competition. As competition for customers is intense in high technology, marketing and the organization of distribution have been problems in trade to western markets. The best companies have managed to cross this threshold.

IMPORTS ARE VITAL TO PRODUCTION

Imports account for 61 per cent of high-tech sales in Finland, while 52 per cent of domestic production goes to exports and this share is rapidly growing all the time. The figures serve to underline the high dependence of the Finnish economy on foreign technology and markets (Table 2).

Overall, the growth of demand for high-tech products has been as fast in Finland as in OECD countries on average during the last 15 years. Nevertheless, the share of high-tech products both in production and exports is smaller than the average in OECD countries.

In the application of imported or domestically developed technology Finland has been in the international mainstream in many sectors. In 1987, there were 8.5 industrial robots for every 10 000 workers in the manufacturing industry, which represents the average in the EC countries. Over the past ten years, the computer market has expanded more rapidly in Finland than in the OECD countries on average. At present, in-

vestment in computer hardware amounts to approximately 1.0 per cent of GDP, which corresponds to the average level in the EC countries.

As regards numerically controlled machines, Finland lags behind other countries; only about one-third of the machine tools sold are NC machine tools. This is due to the short production runs for many special products, the small scale of consumer goods production and the fact that heavy metal industry still accounts for a large share of the engineering industry.

Domestic production could not have been started without technology transfer, imported industrial equipment and parts and components. This has been accompanied by Finland's own domestic applied R & D, by means of which know-how has been converted into products and manufacturing methods. R & D has mainly been carried out by companies; the Technical Research Center of Finland has functioned as transfer agent in some projects of national importance.

Finland's self-sufficiency in the basic components needed in the production of high-tech products is very low. Therefore, reliable contacts between domestic manufacturers and foreign suppliers and prompt delivery of components are of vital importance. As Finland's trade with western markets and

TABLE 2. THE SHARE OF EXPORTS OF HIGH-TECH PRODUCTS IN TOTAL PRODUCTION AND OF IMPORTS OF HIGH-TECH PRODUCTS IN DOMESTIC DEMAND AND THE BALANCE OF FOREIGN TRADE (EXPORTS AS A PERCENTAGE OF IMPORTS) IN FINLAND IN 1970, 1975, 1980 AND 1985, PER CENT^{1, 2}

	Share of exports in production	Share of imports in domestic sales	Balance (exports as a percentage of imports)
1970	37.3	74.5	20.2
1975	36.7	67.0	28.5
1980	50.3	67.2	49.4
1985	51.5	60.5	69.3

¹ High-tech products include the following items: numerically controlled (NC) machine tools; industrial robots; telecommunications equipment excl. cables; fibre optics; industrial automation and measuring equipment; ADP equipment and parts; and medical, electromedical and analytical instruments.

² Approximate figures.

high-tech manufacture have grown, contacts with suppliers and foreign licensing authorities have improved. At present, there should not be problems with the supply of any critical components, and, consequently, no obstacles to the development and manufacture of increasingly sophisticated products.

EXPORTS BOOST PRODUCTION

According to recent studies, Finnish high-tech production should continue to grow fairly favourably in the 1990s. The main impetus will still come from exports, which are expected to gain a growing market share abroad. It should be possible to achieve this by entry into new manufacturing sectors, by introducing new products and by opening up new western markets. Besides actual exports, operations in major market areas will become increasingly important. Business acquisitions in Sweden, the EC countries and the USA have provided a basis for international operations.

Domestic demand is also expected to develop fairly favourably. Imports have traditionally accounted for a large share of domestic demand, and no further significant growth is expected in this share.

As a result, an ever-increasing proportion of production will be exported, and the engineering industry will rapidly become more technology-intensive. According to forecasts, the share of high-tech production going to exports will amount to almost 60 per cent in 1990.

At the same time, the engineering industry will continue to undergo structural change; the share of high-tech products is forecast to amount to some 18 per cent of the sector's output in 1990. The pace of structural change will be boosted by the slow growth of or even fall in the production of old, heavy technology.

The trade balance in high

technology has improved continually, though it still shows a deficit. In 1985, high-tech exports accounted for almost 70 per cent of high-tech imports. It seems likely that balance in this trade will be achieved in the mid-1990s (Table 2).

TRADE POLICY THREATS AND OPPORTUNITIES

The efforts of Western European countries and Japan to create a strong trade bloc based on their own technology will create a tripolar source of technology replacing the former dominance of the USA in technology. Such a course of development will be supported by the fact that the Japanese have caught up with the USA in the field of microcircuit and computer technology and by Japan's superiority in the robot and NC machine market.

The development of new technologies under a number of European multinational research programmes and the creation of the single European market in 1992 will reinforce the trend towards the tripolarity of technology.

The response of the USA has been the SDI (Strategic Defence Initiative) programme and the "militarization" of basic research, which offers a way of preventing the transfer of technology to competitors. It is hoped that SDI will have spin-off effects similar to those of the APOLLO programme in the 1960s. The present advances in, for instance, microcircuits and computer technology have their origins largely in the application of the research results of the APOLLO programme, the main aim of which was a manned flight to the moon.

The future tripolar development of technology may have both positive and negative implications. At worst, it contains the seeds of a new round of trade war and protectionism as technological progress will become less predictable and more difficult to control than before. It also threatens "the na-

tional interests" of the USA in many new sectors and may also deprive US defence of its technological superiority, as has already happened in trade policy.

At best, the consolidation of the technological base will promote internal and external trade in these areas and create more scope for small nations like Finland to buy and sell high technology. The economic strengthening of the EC area is likely to intensify its economic relations with Finland. Traditionally, these links have been strong but they have weakened with the slow economic growth of the EC area and new markets have had to be sought elsewhere.

Full utilization of economic integration in the EC and the results of technological development may, however, be hampered by demands for political integration, which would run counter to Finland's policy of neutrality. Consequently, the alternatives offered by Japan and the USA will remain important for Finland's national technology strategy. Imports of technology from the USA and Japan may partly compensate for research results reserved solely for EC members.

There are no significant barriers to exports of high technology to western markets. A more serious problem for Finland is the limited resources of companies in the integrating market. The need for resources is further increased by the requirements of technological advance and, above all, comprehensive marketing. Instead of international markets one can talk about international products, for which there has to be adequate demand. Marketing requirements are likely to lead to an increase in joint ventures and other forms of cooperation in manufacturing between Finnish and foreign companies in the years ahead.

November 4, 1988

EUROPEAN INTEGRATION AND FINLAND

by **Veli Sundbäck**, Deputy Director-General
External Economic Relations
Ministry for Foreign Affairs

Europe is the key area for Finland's foreign trade, accounting for some 80 per cent of Finland's total imports and exports. The share of the EC in Finland's total trade is over 40 per cent, that of EFTA over 20 per cent and that of Eastern Europe some 15 to 20 per cent.

The outcome of the integration processes currently under way in Europe is thus vital for the economic interests of Finland. It is essential that Europe remains the major market for Finnish products, and an area to which Finnish exports have open access. This article describes Western European integration. Developments taking place in Eastern Europe and between Eastern and Western European countries are not discussed. It should be stressed, however, that these developments are of great importance for Finland, which is a strong supporter of pan-European cooperation.

FINNISH PARTICIPATION IN EUROPEAN INTEGRATION

Finland adopted an open economic strategy as early as 1957. Trade with western countries was liberalized and put on a multilateral basis. When, in the late 1950s, the integration process led to the creation of the EEC and EFTA, Finland safeguarded her economic and trade interests by concluding an agreement with EFTA in 1961.

This first phase in Finland's policy of economic integration was followed by a new phase in the early 1970s. After the UK and Denmark had joined the

Community and other EFTA countries had sought free trade agreements with it, a risk emerged that a significant part of Finnish exports might fall into a disadvantaged position. Finland thus found herself in a situation similar to that some ten years earlier. She had again to adapt herself to the changing economic and trade environment in order to safeguard her vital interests. This was done by concluding a free trade agreement with the EEC. As a result of the new free trade agreements, a Western European free trade area comprising of 16 countries came into being.

FINLAND'S TRADE WITH EFTA AND THE EC

The free trade agreements with EFTA and the EC have worked well. Trade has developed in a balanced manner and its structure has been diversified. Finnish exports have gained significant market shares in the EFTA area, mainly in the other Scandinavian countries. In the EC, Finland has maintained her market shares. Contrary to the fairly widespread fears expressed in Finland, no major difficulties have been encountered as a result of increased imports from EFTA and EC countries. Unlike most other EFTA countries, Finland runs a surplus in her trade with the EFTA/EC area.

The bulk of Finnish-owned companies abroad are located in the EFTA/EC area. At present, there are more than 900 Finnish firms in the Community and some 700 in EFTA countries. Two-thirds of total net foreign direct investment by Finn-

ish firms have taken place in Western Europe.

EUROPEAN INTEGRATION ENTERS A NEW PHASE: AN INTERNAL MARKET IN THE EC BY 1992

Until recently, the European Communities remained primarily a customs union in terms of their degree of integration: a Community with a common foreign trade policy, a common agricultural policy, a largely common competition policy, and common objectives in the area of political cooperation. In the space of 30 years, the original "six" developed into the "twelve". The enlargement took place at least partly at the expense of the deepening of economic integration.

In the past few years, the situation in the Communities has changed radically. In 1985, the Community, by then a market comprising over 320 million people, approved a plan for the creation of an internal market by the end of 1992. The Single European Act provided for qualified majority voting rather than unanimity in adopting Community legislation. Expectations of a real and qualitative change in integration rose. In early 1988, the Community solved the long-standing problems of financing the EC budget, and made the momentous decision to increase the structural funds providing financial assistance to poorer regions of the Community.

Basically, the creation of the internal EC market implies the implementation of the "four freedoms": the free movement of goods, services, capital and people.

The same freedoms are already included in the founding charter of the EEC, the Treaty of Rome. Now a timetable has been laid down for the programme and the rulings of qualified majority voting have been provided for.

CHALLENGES FOR FINLAND AND OTHER EFTA COUNTRIES

What are the economic implications of the internal market for other Western European countries belonging to the same free trade area, and how are they responding to the challenges?

Finland and the other EFTA countries have repeatedly stated their recognition that the success of the internal market is of vital importance for the European economies. They therefore support the Community in this endeavour.

The implementation of the internal market is the best way to achieve the fundamental goal of creating better conditions for sustained growth throughout the EC. Such growth is likely to increase demand in the main export markets of the EFTA countries. They recognize the potential benefits to be reaped from a successful deepening of EC integration.

They are equally aware, however, that the completion of the Community's domestic market entails the risk of weakening their competitive position. They have therefore urged the EC to consolidate and strengthen mutual cooperation between EFTA and the EC at the same time as the EC progresses towards completion of its internal market with the aim of extending the benefits of integration to all countries belonging to the Western European free trade system.

LUXEMBOURG DECLARATION OF 1984: THE EUROPEAN ECONOMIC SPACE

The meeting in Luxembourg in April 1984 was the first joint

meeting between the EC and EFTA to be held at ministerial level. This meeting had a dual purpose. Apart from celebrating the successful implementation of the free trade agreements, it also offered an opportunity for ministers to look ahead and identify new common tasks. The ministers expressed the political will to create a dynamic European Economic Space, the EES, comprising of all the 18 EFTA and EC countries. The concept of the EES has only been defined in rather loose terms. It should not be seen as a new organisation but rather as an ongoing process.

It is in the interest of neither EFTA nor the EC at this juncture to be too precise about the EES. The essence of the EES is parallel development between EC and EFTA countries, providing benefits for all.

So far, the concrete results of this new EFTA/EC dialogue have been limited, though far from insignificant. Two conventions on trade documentation and transit documents have been signed. Decisions have been taken on a large number of issues such as technical barriers to trade, trade facilitation, origin rules, public procurement, state aids, education and training, research and development. Cooperation has progressively been extended to new areas. At present, work is being carried on in some 20 specific fields.

At the second joint ministerial meeting in February 1988, the ministers took stock of the progress made. They adopted a declaration that explicitly describes the relationship between the EC and EFTA as "a special relationship". The declaration furthermore commits the new members of the EC, Spain and Portugal, to the process of creating the EES.

THE FINNISH POSITION

In responding to the challenges of deepening integration, Finland takes as a starting point her established

trade policy. The aim is to safeguard economic and trade interests in a way that is consistent with the policy of neutrality.

The considered Finnish view is that this policy of neutrality cannot be reconciled with full membership of the EC.

Intensified economic cooperation in Europe is, however, essentially in the interest of Finland. Consequently, Finland takes an active part in the ongoing integration process.

For both substantive and practical reasons Finland prefers the joint EFTA approach as the main means of cooperation. This is also the approach preferred by the EC. We need, however, to retain the possibility of bilateral negotiations and decisions with the EC. Intensified economic cooperation among the Nordic countries could make a useful contribution to more extensive West European integration.

Free movement of goods within the EFTA/EC area is undoubtedly in Finland's interest, though certain restrictions would still be necessary as regards trade in agricultural goods. In the area of services and capital movements progress should be made gradually and on the basis of experience. Finland is unlikely to encounter any major difficulties in these fields not experienced by the EC countries or other EFTA countries.

The situation is more complicated in the case of free movement of people. On the one hand, there is keen interest in cooperating in the training sector. Sharing the reciprocal benefits of the EC's major training programmes offers a means of keeping research up to date and maintaining industrial competitiveness. On the other hand, there is need to retain control over aliens and manpower policy.

PRINCIPLES APPLIED BY THE EC IN COOPERATION WITH EFTA

The EC's general negotiating position towards EFTA rests

on the following principles:

- integration within the Community has absolute priority,
- the autonomy of decision-making and action must be safeguarded,
- there must be a balance between benefits and obligations; cooperation should be based on "real reciprocity",
- no area of cooperation should be excluded **a priori**.

From the Finnish point of view, these principles are understandable. Finland, too, gives priority to her own interests and is determined to retain decision-making in her own hands. We fully recognize the need for reciprocity and keep an open mind as regards exploring opportunities for cooperation in all areas of the "four freedoms".

Yet these principles imply that the EC intends to go ahead with its integration without waiting for the EFTA countries. The latter must therefore step up their own cooperation or act unilaterally in order to safeguard progress parallel with Community developments.

The second principle suggests, in practice, that the EFTA countries should closely follow developments in the Communities and be able to react quickly whenever they have a chance to express their views on the Community's draft legislation. As a consequence, cooperation within EFTA will have to be further intensified. Finland has made a number of practical proposals in this respect and welcomes the steps taken to strengthen EFTA machinery so as to be able to keep pace with developments in the EES.

The third principle of "real reciprocity" also seems reasonable enough. It should be recalled, however, that there is no general agreement within the EC as to exactly what real reciprocity should constitute. Accordingly, the fulfilment of this principle will require negotiations between the parties. The need for global liberalization of

international trade will also have to be borne in mind.

METHODS OF COOPERATION

The contractual relations between the EFTA countries and the EC are based on bilateral free trade agreements. Nevertheless, the EFTA countries have underlined that EFTA can play a key role as their vehicle for cooperation and negotiations with the EC.

At the ministerial meeting in February 1988, the EFTA and EC countries agreed that cooperation between them could best be furthered pragmatically along both multilateral and bilateral lines. For a number of reasons, both substantive and practical, sectoral multilateral EFTA/EC arrangements should serve as the main means.

Similarly, bilateral arrangements could be resorted to in issues that do not interest all individual EFTA and EC countries. R & D is a typical example of the bilateral approach. On the basis of the framework agreement with the EC, Finnish partners are already participating or preparing to participate in a significant number of EC programmes and projects.

Another important means — applied, for example, in the fields of technical regulations and state aids — is to develop an internal EFTA system compatible with EC arrangements, thereby providing a basis for bridge-building between the two systems.

A further way is for the parties to automatically and unilaterally ensure that their internal legislation has the same, or similar, compatible content, thereby avoiding any unnecessary obstacles to economic relations.

Adaptation of respective legislations would of course be much facilitated by an efficient and early information and consultation procedure. To some extent such procedures are already applied but they should be made more systematic and

comprehensive in order to render possible more extensive use of the notion of mutual recognition of laws, regulations and standards as an instrument for EFTA/EC cooperation.

FUTURE PROSPECTS

Up till now, the EFTA countries and the EC have worked towards the common goal in a pragmatic manner step by step. This approach has satisfied all concerned. As the process of integration proceeds, a clearer concept and vision of how relations between the EFTA countries and the EC should be arranged in the future might be called for. This should, of course, be developed jointly by the countries and organs of EFTA and the EC.

REGIONAL INTEGRATION IN RELATION TO GLOBAL LIBERALIZATION

Finland remains an avid supporter of the open world trade and financial system. We do not see European integration as an end in itself but as a contribution to the growth of world trade. "Fortress Europe" or "Europe for Europeans" cannot be the answer to this continent's problems. To ensure that regional developments continue to impart positive impulses to the world trading system and **vice versa** it is of vital importance that the ongoing GATT negotiations, the Uruguay Round, play a central role in the liberalization of world economic relations. This is in our national interest and to that end we seek to make an active contribution.

October 3, 1988