



FINANCIAL MARKETS IN FINLAND

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A series of articles
which appeared in
the Bank of Finland
Monthly Bulletin
in 1970-1972
Revised in 1978

1965

THE FINNISH FINANCIAL MARKETS

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ARKISTOKAPPALE

This issue includes a series of articles on the Finnish financial markets. They were originally published in the Bank of Finland Monthly Bulletin between 1970 and 1972. The present articles have been revised to include the developments of financial intermediation in the 1970s, when many of the trends seem, at least temporarily, to have changed. The purpose of this article is to introduce the series by briefly outlining the principal characteristics of the Finnish financial markets.

SAVING IN FINLAND

The average propensity to save in Finland is very high. Gross saving (including depreciation) in the years 1966—1975 has varied between 26 and 33 per cent of the value of the GDP and the average was a little over 29 per cent. Of this, approximately 35 per cent has been accumulated by households, 33 per cent by the business sector and 32 per cent by the public sector.

The extent to which the financial markets are responsible for transferring the savings of each sector to investment in other sectors cannot be satisfactorily estimated. However, the household sector's own investment amounted to just over 80 per cent of its saving whereas the business sector's investment (including stockbuilding) was almost 70 per cent greater than its savings. In the public sector, investment was approximately three quarters of total saving so there were remarkable surplus funds in the public sector in the period 1966—1975. Total gross investment in Finland exceeded total saving by about 8 per cent during that period. The deficit was financed by the net inflow of foreign capital, a major part of which was direct foreign borrowing by industrial companies. The surplus savings of the household sector were, no doubt,

mainly channelled through the organized financial markets to cover the financial deficit of the business sector. The surplus savings of the central government were mainly channelled to the household sector. In addition, it is clear that within each sector most of the flow of funds from surplus units to deficit units passed through the financial markets. The available statistics do not, however, give a reliable picture of these intra-sectoral financial flows.

The relative size of the financial markets in Finland may be illustrated by the fact that the financial assets of the non-financial sector, (i.e. households, enterprises and the public sector), in the form of money, bank deposits and bonds totalled less than 50 per cent of GDP at the end of 1965 and some percentage points less by the end of 1975. This decrease reflects mainly the erosion of the real value of the assets as a result of the high rate of inflation during the mid-1970s.

THE STRUCTURE OF THE FINNISH FINANCIAL MARKETS

The most notable characteristic of the Finnish financial markets is the dominant position occupied by the deposit banks, which is reflected in such features as the minor role of other financial institutions and the underdeveloped security market.

In particular, the deposit banks' role is central in the markets for claims held by households and firms. At the end of 1975 the amount of demand and time deposits in banks was 40 000 million marks whereas the amount of domestic bonds outstanding was only 4 900 million marks and the amount of currency in circulation 2 900 million marks. The relative share of bonds and currency declined distinctly in the ten years

before 1975, but since then the trend has been changed by the growing issue of government bonds. No corresponding figures are available for the role of equity shares in the financial markets. One possible indicator is the market value of the shares of companies quoted on the Helsinki Stock Exchange. The equity capital of these companies is roughly a third of the total capital of the corporate sector, and its market value was 5 400 million marks in August 1977.

DEPOSITS MADE BY THE PUBLIC

	1965		1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Commercial banks	3 859.5	38.6	16 040.1	40.1 ¹
Savings banks	3 044.2	30.5	10 412.2	26.0
Co-operative banks	2 007.8	20.1	8 072.2	20.2
Postipankki (Post Office Bank)	1 082.2	10.8	5 509.8	13.7 ¹
Total	9 993.7	100.0	40 034.3	100.0
Savings departments of the co-operative stores	357.2	(3.6)	1 093.6	(2.7)

¹ Including domestic deposits in foreign currency.

THE BANK DEPOSIT MARKET

There are various types of institution in the Finnish bank deposit market. Deposits by the general public are accepted at the commercial banks, which are legally constituted as joint stock companies; at the savings banks, which in law are a kind of non-profit foundation; at the co-operative banks, which are co-operative societies; and the Postipankki (Post Office Bank), which is a special institution owned by the State. As well, the savings departments of the co-operative stores accept similar deposits by their members. Of these deposit banks, the commercial banks are highly centralized, with the two largest having a dense network of branches all over the country. The savings banks and the co-operative banks are mostly local institutions with only a few branches, if any. The savings banks and the co-operative banks, however, both form nationwide systems having their national association and their own central banks, which are formally commercial banks. The table below shows the shares of the public's total deposits that these various institutions held at the end of 1965 and 1975.

The table reveals that no great changes have occurred in the market shares of the various institutions during the period in question. The Postipankki has, however, somewhat increased its share at the expense of the savings banks. The rise in the share held by commercial banks is partly due to a change in the compilation of the statistics as only a part of the domestic deposits in foreign currency were included in deposits in 1965.

In this connection two more characteristics of the Finnish bank deposit market may be mentioned. All the above institutions apply the same conditions in the acceptance of demand and time deposits (the savings departments of co-operative stores do not accept demand deposits), so there is no competition by means of deposit rates. These conditions are decided by the Joint Delegation of the Banking Institutions, which has representatives from each of these groups of institutions.

The deposit banks have developed a very extensive network of branch offices, which is supplemented by the post office network used by Postipankki; this has partly been created to compensate for the lack of competition on deposit rates. This network provides a considerable competitive advantages for the deposit banks vis-à-vis other types of financial institutions, as it makes the use of bank deposits very convenient.

Another characteristic of the Finnish deposit market is the fact that the ratio of demand deposits (including postal giro accounts) to all bank deposits is very small — on average less than 20 per cent. This is due to the fact that a fairly large amount can be withdrawn on demand, without loss of interest, from the most popular term deposit accounts, which formally require 6 months' notice of withdrawal. At the moment the upper limit for this type of withdrawal is 5 000 marks per month and the rate of interest is 4¼ per cent per annum. As demand deposits are paid little or no interest it

is not surprising that a considerable part of the liquid assets of households and small enterprises is placed in these term deposit accounts. One consequence of this special feature, strengthened by a well-developed bankgiro system, is that the narrow definition of money often used in international comparisons is unsatisfactory for Finnish purposes.

The reasons for the predominance of deposit banks in the Finnish financial markets have not been explained in detail. To some extent the reasons are historical: the share of assets other than bank deposits has always been small. Thus, deposits are the only asset well-known to the general public. The tax treatment of deposits — to households they are free of both income and wealth taxes — has been very favourable and especially compared with that of shares. Although this is also true of bonds, the growth of the bond market has been hampered by rationing the issue of private bonds in favour of government bond issues. On the other hand, although the real rate of interest on bank deposits has at times been negative, the attractiveness of deposits has been increased by the fact that banks give preference to their deposit customers when granting loans.

THE CREDIT MARKET

Despite the dominance of the deposit banks there are a number of other types of financial institution in Finland. They include the insurance companies, the National Pensions Institute and various non-corporate insurance institutions which grant loans from their funds, and the mortgage banks which mainly collect their funds by means of issuing bonds. Moreover, the Bank of Finland has granted direct loans to the public. These have been primarily within special credit arrangements agreed upon with the commercial banks and Postipankki. There are also a couple of development credit institutions specialised in the financing of industry, exports, and investment in less developed areas, hire purchase and credit card companies, and factoring and leasing institutions. In addition, in 1975 a new State Investment Fund was es-

tablished. It has no independent organization of its own, but grants loans to industry via Postipankki. The various credit institutions will be described in more detail later in this series and therefore only a broad picture of their relative importance is given here.

The following table shows the shares of the various institutions in total credits granted to the public at the end of 1965 and 1975. It also shows direct lending to the public by the State and direct long-term foreign borrowing by the firms and local authorities.

CREDITS GRANTED TO THE PUBLIC BY THE FINANCIAL INSTITUTIONS¹

	1965		1975	
	Mill. mk	Percent	Mill. mk	Percent
Commercial banks	4 300.6	22.6	21 135.5	23.7
Savings banks	2 616.3	13.7	9 099.5	10.2
Co-operative banks	2 352.1	12.3	7 796.3	8.7
Post office bank (Postipankki)	700.6	3.7	5 827.2 ²	6.5
Deposit banks, Total	9 969.6	52.3	43 858.5	49.1
Insurance companies	1 853.9	9.7	8 734.6	9.8
Pension funds (and cashes)	1 002.0 ³	5.3	3 151.9	3.5
Mortgage banks	905.5	4.8	4 131.7	4.6
Development credit institutions	161.5	0.8	3 220.2 ⁴	3.6
Bank of Finland	158.6	0.8	1 204.9	1.4
Hire purchase institutions	111.8 ⁴	0.6	504.0	0.6
Other financial institutions, Total	4 193.3	22.0	20 947.3	23.5
Direct loans granted by the state	2 713.4	14.2	8 615.2	9.7
Public social security funds	1 326.4	7.0	2 410.2	2.7
Direct long term foreign credits	863.0	4.5	13 395.0	15.0
Total	19 065.7	100.0	89 226.2	100.0

¹ According to the credit market statistics. Because of changes in accounting practices, not all of the figures are strictly comparable.

² Including loans from the State Industrial Fund.

³ Estimated; the figure is not available for before 1968.

⁴ Includes factoring companies.

The table indicates, first of all, the predominance of the deposit banks among the domestic credit institutions. Their share in total lending by these institutions to the public is still more than two-thirds, but the share of savings banks and co-

operative banks has clearly decreased. The significance of Postipankki has grown partly because the healthy state of central government finances in the early 1970s made it possible for Postipankki to shift its credit granting towards the general public. If the central banks of the savings banks and the co-operative banks, which are included with the commercial banks in the above table, are included in savings banks and co-operative banks respectively, the share of both of these groups will rise by 1.5—2 percentage units while the share of the commercial banks proper will be reduced by about 3.5 percentage units.

Further, it can be seen that there have been some significant changes in the relative shares of the other credit granting institutions or sectors. The public sector, including the National Pensions Institute, has experienced a reduction in its share as have also, to some extent, the private non-corporate insurance institutions. The greatest gains among the domestic institutions have been achieved by the development credit companies.

However, by far the most significant change has taken place in the direct long-term foreign borrowing by firms. Its share of total credits has increased by more than 10 percentage points in 1965—1975. Such a large inflow of finance has had its effects on domestic financial markets too. For example, the extensive reliance of larger firms on foreign credits has made it easier for other sectors to use domestic finance. Foreign borrowing is under the control of the central bank, although the degree of rationing has varied considerably in the period under review.

There are some systematic differences between the groups of institutions in their distribution of credit to different sectors of the economy.

A breakdown, into seven sectors, of total credits granted by financial institutions at the end of 1965 and 1975 is given to provide a reference background for the sectoral distribution of credits that will be presented in the articles following.

There have been some changes in the structure of lending in the period 1965—1975. The share of manufacturing, mining and quarrying has clearly increased and to some extent also that of personal and miscellaneous credits, whereas those of some other sectors, agriculture and construction in particular, have declined remarkably. The table does not include foreign credits and central government lending which has to be taken into account when comparing the shares of debtor sectors. For example, the construction of power and electricity plants has been financed mainly by foreign borrowing.

CREDITS GRANTED TO THE PUBLIC BY THE FINANCIAL INSTITUTIONS,¹ CLASSIFIED BY SECTOR

	1965		1975	
	Mill. mk	Percent	Mill. mk	Percent
1. Agriculture, forestry and fishing	1 615.5	12.3	4 462.8	7.3
2. Manufacturing, mining and quarrying	3 522.6	26.8	20 361.0	33.0
3. Electricity, gas and water	451.8	3.4	1 435.5	2.3
4. Construction and real estate	2 130.3	16.2	8 038.8	13.0
5. Trade, communications and other service industries	2 247.7	17.1	10 490.0	17.0
6. Municipalities	529.4	4.0	3 060.0	5.0
7. Personal and miscellaneous credits	2 663.6	20.2	13 805.8	22.4
Total	13 160.9	100.0	61 653.9	100.0

¹ Excluding non-corporate insurance institutions and public social security funds.

The nominal rates of interest on lending — as on deposits — has been fairly steady and low when one takes the rate of inflation into account. This has resulted from the interest rate policy applied, which will be dealt with in more detail later on. As a result, there seems to have been an almost chronic excess demand for credit which has necessitated considerable non-price rationing of credits by lenders.

No exact information is available on the length of time for which credits are granted in the Finnish financial market but, as the deposit banks dominate the credit market, the average

length of loans tends to be relatively short. This can be seen as a way of compensating for the comparatively low level of real interest rates in the credit market. The shortage of opportunities to raise long-term capital from domestic financial markets has anyway been recognised as a problem for the Finnish financial markets.

THE SECURITY MARKET

Securities similar to those traded in other countries do exist in Finland, but their importance is relatively small. Bonds, which in most cases have enjoyed the taxation privileges of bank deposits, have been continuously issued to the public. There thus exists a limited primary market for these securities. However, a bond is normally held for its entire life by the original buyer. Also, there is no significant trade in shares, so the secondary market for securities is only very marginal. A picture of the significance of the secondary market in Finland is given by the annual turnover on the Helsinki Stock Exchange, which is the only one in the country. These figures are shown in the table below.

ANNUAL TURNOVER OF THE HELSINKI STOCK EXCHANGE, MILLION MARKS

	1965	1975
Shares	24.2	143.1
Rights to subscription	4.8	48.7
Bonds	5.3	13.4
Debentures	0.5	2.7

In comparison with the total securities outstanding, the turnover on the Stock Exchange is very small. The annual turnover of bonds,

debentures and shares totals only some 1—2 per cent of the total securities outstanding. It will also be noticed that the annual turnover on the Stock Exchange in the years under review has been no more than 0.1 to 0.3 per cent of the GDP of the relevant year.

The limited size of the security market has prevented the effective formation of market interest rates and has been one of the factors enabling the policy of rigid nominal interest rates to be pursued in the other sectors of the financial markets. In addition, the underdeveloped security market, together with the above-mentioned tax treatment of various financial assets, has up to now impeded the development of institutions for collective investment, such as mutual funds or investment trusts. In 1977, however, the Finnish Government introduced an Investment Trust Bill which, if passed, will provide legal basis for the establishment and operation of investment trusts. It should also be mentioned that there is no Treasury bill market. Since 1975 a rather narrow call money market has been in operation. This market was created by the Bank of Finland and it substituted the former rather unorganized call money market between the commercial banks.

The special features of the Finnish financial markets briefly described above affect their whole operation and dynamics. They also influence the monetary policy of the Bank of Finland, which has to take account of circumstances very different from those prevailing in countries having more diversified and developed financial markets.

THE BANK OF FINLAND

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In the present series of articles on Finnish financial institutions, two articles on Finland's central bank, the Bank of Finland, are included. The first deals with the tasks and position of the Bank of Finland and the second with monetary policy in Finland.

THE TASKS OF THE BANK OF FINLAND

The most important tasks of the Bank of Finland are in the area of monetary policy. In addition, the Bank is involved in many other areas of economic, and especially counter-cyclical, policy. The Bank is required by law to submit statements for policy-makers or in other ways to participate in the preparation of policy decisions.

As new means and methods of payment have been developed, there has been a decline in the significance of the Bank of Finland as the centre of the country's monetary and payments systems. Nonetheless, it continues to manage note circulation and to function as the clearing centre for domestic banking institutions. In addition, the Bank of Finland is the central organ of the country's foreign exchange market. Foreign exchange rate quotations are fixed at its daily meetings with the banks.

It is also the task of the Bank of Finland to act as an agent for the Government in its relations with the international financial organizations which Finland is a member of, such as the International Monetary Fund, the World Bank, the International Finance Corporation and the International Development Association. In addition the Bank of Finland is a shareholder in the Bank for International Settlements.

THE ADMINISTRATIVE POSITION OF THE BANK OF FINLAND

The Bank of Finland was founded in 1811, two years after Finland was separated from Sweden and incorporated into the Russian Empire as an autonomous Grand Duchy. The Bank was subordinated to the Senate (Cabinet) at the time of its foundation. In 1868 the Bank was placed under the supervision of the Diet (Parliament) instead of the Senate, and special Bank Supervisors elected by the estates of the Diet began to superintend its activities. A similar administrative arrangement was instituted when the country became independent in 1917. The Constitution provides that »the Bank of Finland shall be managed by Parliament and shall operate under its guarantee and shall be supervised by the Bank Supervisors of Parliament». The administration of the central bank was thus organized on the same lines as that of the Swedish Riksbank which has been subordinated to Parliament since it was founded in 1668.

The present administrative position of the Bank of Finland is defined in more detail by the Regulations for the Bank of Finland, which have the status of law and are passed according to normal legislative procedure. There have been no major revisions of the present Regulations which date from 1925, although many details have been changed. According to the Regulations for the Bank of Finland, the administration of the Bank lies mainly in the hands of the Bank Supervisors of Parliament and the Board of Management of the Bank.

The Bank Supervisors, of whom there are nine, are elected by Parliament for the life of that Parliament. In the election the principle of pro-

portional representation is followed so that the party affiliations of the Bank Supervisors reflect the distribution of seats in Parliament. The Bank Supervisors do not have to be members of Parliament and, according to the present Regulations, members of the Cabinet cannot be Bank Supervisors. The primary task of the Bank Supervisors is to superintend the administration and management of the Bank. In addition, certain important decisions on the Bank's activities are made by the Bank Supervisors, for example the determination of the rates of interest charged by the Bank, especially the rate on central bank credit granted to banking institutions. Similarly, the Bank Supervisors determine the rates of interest paid on deposits with the central bank. The Bank Supervisors also decide on the acquisition, building, selling or donating of real estate, on borrowing abroad and on the issue, denomination and design of new bank notes. They decide on the distribution of tasks among the members of the Board of Management of the Bank and appoint the Directors of the Bank and the Managers of the branch offices. Certain decisions concerning Bank personnel are also made by the Bank Supervisors.

The Board of Management of the Bank, which comprises five members besides the governor, is appointed by the President of the Republic on the basis of the Bank Supervisors' proposals. However, the President is not bound to follow the Bank Supervisors' suggestions. All matters which have not been explicitly delegated to the Bank Supervisors are taken care of by the Board of Management. Consequently, the Board of Management alone decides on the use of many important monetary policy instruments.

The Bank of Finland is formally fully independent of the government. However, the law calls for co-operation between the Bank of Finland and the government when some important economic policy decisions are being made. Thus, for example, a decision to change the international value of the mark can be made by the government only at the suggestion of the Bank of Finland. The government may then either approve or reject the Bank's proposal; in the

latter case the value remains unchanged. A similar stipulation applies to the granting of issuing rights for domestic bonds. Issuers other than the state must gain permission to issue bonds from the Cabinet. Before discussing the application, the Cabinet must have the opinion of the Board of Management of the Bank and cannot grant permission if the Bank opposes the application. In many other matters of economic policy the government is obliged to consult the Bank before reaching a decision, but co-operation between the Bank and the government is otherwise unregulated. In practice, co-operation is fairly close, depending to some extent on the persons involved. The independence of the Bank from the government is emphasized by the fact that if a member of the Board of Management of the Bank is appointed to a ministerial post he must ask the Bank Supervisors for a leave of absence from the Bank. Consequently a minister cannot be a member of the Board of Management of the Bank or a Bank Supervisor.

STRUCTURAL FEATURES

The activities of the Bank of Finland are greatly centralized, based at the head office in Helsinki. The tasks of the twelve branch offices in the largest cities of the country are primarily technical and connected with note circulation and payments. The Bank of Finland has a note-printing works, which carries out other demanding printing tasks as well. The coins in circulation are issued by the Bank too, but they are made by the Mint, which is under the Ministry of Finance.

The numbers of people employed by the Bank at the end of 1965 and 1975 are shown in the table below.

TABLE 1. THE BANK OF FINLAND'S PERSONNEL

	At the end of the year	
	1965	1975
Head office	411	646
Branch offices	193	306
Note-printing works	204	433
Total	808	1 385

THE BANK OF FINLAND'S FINANCIAL ACTIVITIES

The nature of the financial activities of the Bank are reflected in the Bank's balance sheet. When the new Accounting Law came into force at the beginning of 1974, the Balance Sheet and the Profit and Loss Account of the Bank were revised in connection with the closing of the books for 1974. In the Balance Sheet, the items on the assets and liabilities side have been classified, as far as possible into five sectors: foreign sector; financial institutions; public sector; corporations; and others. In the following, the Balance Sheet for 1965 was reconstructed according to the new law so that it is comparable with that of 1975. Because it was not possible to revise the Income Statement, it concerns only the year 1975.

LIABILITIES

The major part of the liabilities of the Bank usually consists of »notes in circulation», which, in connection with the balance sheet revision in 1974, was combined with »coins in circulation» into a new balance sheet item »notes and coins in circulation». This item is a larger pro-

TABLE 2. BREAKDOWN OF THE BANK OF FINLAND'S TOTAL LIABILITIES

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Foreign exchange liabilities	55.6	3.0	171.7	2.0
Other foreign liabilities	45.5	2.5	1 385.2	15.7
Notes and coins in circulation	1 080.0	59.1	2 855.1	32.4
Deposit certificates in circulation	—	—	250.1	2.8
Claims of financial institutions	20.4	1.1	124.0	1.4
Claims of the public sector	2.2	0.1	1 300.6	14.8
Claims of corporations	11.7	0.7	538.7	6.1
Other liabilities	20.0	1.1	14.9	0.2
Capital and equalization accounts	592.4	32.4	2 162.4	24.6
Total	1 827.8	100.0	8 802.7	100.0

portion of the liabilities of the Bank of Finland than of many other central banks. This is mainly due to the fact that in Finland the banks are not obliged either by law or custom to keep permanent cash reserves with the central bank. As the commercial banks are usually continuously indebted to the central bank, it is in their interests to use all the funds accumulating on their cheque accounts at the Bank of Finland to amortize their central bank debt. Consequently the banks' cheque account balances at the central bank are usually very small.

The major part of the foreign exchange liabilities of the Bank of Finland consists of liabilities to the Bank's correspondents payable on demand. The growth in other foreign liabilities is due to new items in the balance sheet: the allocations of special drawing rights and mark accounts of the International Monetary Fund. Other long-term foreign liabilities have existed only occasionally to support the country's international liquidity position.

Claims of the financial institutions include, in addition to the cheque accounts of the private banks, the cheque account of Postipankki and, since 1975, the call money deposits of banks.

Claims of the public and corporate sector comprise mainly various counter-cyclical reserves. At the end of 1975 the claims of the public sector consisted of import deposits, government counter-cyclical reserves, the cheque account of the Treasury, and a small amount in counter-cyclical tax and investment tax accounts and of export levy funds collected in connection with the devaluation. The claims of the public sector do not include deposit certificates sold to the public sector, which are included in the balance sheet item »deposit certificates in circulation».

Claims of corporations at the end of 1975 include mainly capital import deposits, which were collected in order to freeze the liquidity effect of capital imports. Minor items are investment deposits and import levy deposits of corporations.

Notes denominated in the old monetary unit are a major part of the other liabilities of the Bank of Finland. They have not been returned to the Bank, but are generally out of active circulation.

ASSETS

Foreign receivables are one of the major asset items in the balance sheet of the Bank of Finland. Foreign exchange receivables include gold, special drawing rights, the gold tranche in the International Monetary Fund and convertible and tied currencies. Other foreign receivables comprise foreign bills, foreign bonds and currency subscription to Finland's quota in the IMF. The foreign reserves of the Bank of Finland are calculated as the convertible foreign exchange reserve, which is the difference between the convertible foreign exchange receivables and liabilities, and as the tied foreign exchange reserve, which is the difference between the tied foreign exchange receivables and liabilities. At the end of 1975 the former was 1 410 million marks and the latter 370 million marks.

TABLE 3. BREAKDOWN OF THE BANK OF FINLAND'S TOTAL ASSETS

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Gold and foreign exchange receivables	860.9	47.1	1 949.8	22.1
Other foreign receivables	83.8	4.6	1 274.2	14.5
Receivables from financial institutions	669.7	36.6	4 259.2	48.4
Receivables from the public sector	76.7	4.2	339.3	3.9
Receivables from the corporations	120.6	6.6	933.2	10.6
Other assets	16.1	0.9	47.0	0.5
Total	1 827.8	100.0	8 802.7	100.0

The other major asset item is receivables from financial institutions, which include the central bank debt of the commercial banks, holding of bonds issued by financial institutions and, since 1975, call money advances to commercial banks. The banks' central bank liability, which has characteristically been a relatively large share of the Bank of Finland's receivables since the second World War, amounted to 3 790 million marks at the end of 1975.

Receivables from the public sector consist of holdings of bonds issued by the government and the item »total coinage», which is the accounting equivalent of »coins in circulation» on the liability side of the balance sheet.

The Bank of Finland also grants credits directly to enterprises, mainly through special credit arrangements. At the end of 1975 these included domestic suppliers credit, which are used to finance domestic suppliers' deliveries of capital goods to domestic customers, the financing of new export credits, the financing of short term export credits and some other temporary financing arrangements. These have been organized in co-operation with the commercial banks and the Post Office Bank, so that the financing of certain projects or operations has been divided between these banks and the Bank of Finland. In addition to credits to enterprises, receivables from corporations include bonds issued by corporations and held by the Bank of Finland.

EARNINGS AND EXPENSES

Interest earnings from domestic receivables, mainly from lending to the banks, have generally formed by far the largest revenue item for the Bank of Finland. The other important sources of revenue have usually been foreign receivables and domestic bonds.

TABLE 4. DISTRIBUTION OF THE BANK OF FINLAND'S EARNINGS AND EXPENSES IN 1975

	Mill. mk	Per cent
Earnings		
Interest on domestic receivables	513	71.5
Interest on foreign receivables	59	8.2
Interest on bonds	78	10.9
Other earnings	67	9.4
Total	717	100.0
Expenses		
Interest on domestic claims	135	18.8
Interest and commissions of foreign claims	23	3.2
Salaries and social security contributions	34	4.8
Depreciation	59	8.2
Other expenses	33	4.6
Transfer to equalization accounts	240	33.5
Net earnings for the year	193	26.9
Total	717	100.0

The expenses of the Bank of Finland are much more evenly distributed among various items than are its earnings. The largest item of expenses has generally been wage and salary expenditure. In the years when counter-cyclical reserves held by the Bank have been great, interest on domestic claims has exceeded wage and salary expenditure as in the year 1975. Depreciation exceeded wages and salaries in 1975 too, because a new note-printing works

was under construction. Owing to the character of a central bank, the Bank of Finland's bulk of liabilities does not bear interest and thus annual net earnings are rather high in relation to total expenses. In accordance with the Regulations for the Bank of Finland, one-half of the net earnings for the accounting year has been transferred to the reserve fund while the other half has, by Parliamentary decision, been transferred to the Treasury.

MONETARY POLICY IN FINLAND

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This article deals with the framework, objectives, channels and tools of monetary policy in Finland. Although the term monetary policy is used in a rather broad sense, the main emphasis is placed on those measures of monetary policy which are decided upon by the Bank of Finland and intended to affect economic development primarily through financial markets. In addition, similar measures on which the Bank of Finland decides only in concert with other authorities are discussed.

FRAMEWORK

The Finnish economy has a number of features which highlight the operation of monetary policy in a small open economy with a bank-centred financial system. Cyclical fluctuations have been sharper, inflation more rapid and the current account in deficit more often in Finland than in many other OECD countries. On the other hand, investment has been higher, growth faster and unemployment lower than in these same countries. Policy concern has thus generally focused on the former areas.

The large cyclical fluctuations in the growth of GDP are a result of the openness of the economy (exports and imports both amount to about a quarter of GDP) and the pattern of exports. Despite considerable diversification in the past few decades, exports are still rather heavily concentrated in a few commodity categories which are very susceptible to cyclical fluctuations. The sharpness of the cyclical swings and the inability to even them out in turn help to explain Finland's comparatively high inflation rate. The persistent current account deficits and the rapidly growing foreign debt resulting, have been the counterpart of a

growth-oriented economic strategy which requires substantial investment, but they have also been partially the consequences of rapid inflation. Foreign borrowing has supplemented a high domestic savings ratio and the country has succeeded in achieving a satisfactory growth rate by international standards.

The nature of the financial system is of particular importance for the conduct of monetary policy. In this respect, Finland can be characterized as a bank-centred economy. The domestic market in securities — both long and short-dated — is not large enough to be of any great significance either for the financing of economic activity or for the regulation of the liquidity of the economy. The absence of an active market is reflected in the narrow range of negotiable debt instruments, the low substitutability between various claims and the tendency to hold them until maturity.

In contrast, the deposit banking system is highly developed and performs the functions which the market in debt instruments is responsible for in some larger countries. The banking system is characterized by a high degree of oligopoly and strong ties between the banks and their major customers. Thus monetary policy centres not just on the banks in general but on a small number of units.

One factor which makes monetary policy more important in Finland than in many other countries is the nature of the economic policy-making process. Finland is a highly pluralistic democracy where consensus rather than simple majority rule is the foundation for political decisions. Since the creation of consensus is frequently a time-consuming process, it is often difficult to make sharp, quick fiscal policy decisions.

The Bank of Finland, unlike most other central banks, is not subject to the Government but rather to Parliament, which selects the Bank Supervisors who oversee the actions of the Board of Management. The members of the Board are appointed by the President and do not change with the Government. Since the Board wields most of the principal weapons of monetary policy, the Bank of Finland is more able to conduct incisive short-term policy. However, some of the measures, such as changes in interest rate levels, are decided by the Bank Supervisors, having been proposed by the Board.

OBJECTIVES

The objectives of monetary policy in Finland are no doubt very similar to those elsewhere. These comprise rapid and balanced economic growth, high and stable employment, stable prices, adequate foreign liquidity and sustainable foreign indebtedness.

The exact meaning of these concepts has not been any better defined in Finland than in most other countries. However, it is clear that opinions on what constitutes the pith of these matters have undergone continuous change. The change has been especially apparent in the concept of economic growth. Along with the rise in the standard of living in the traditional sense, the relative importance attached to the human environment has increased.

Not only have the exact meanings of the individual objectives of monetary policy changed, but their relative ranking has as well. Naturally, policy measures are always focused on points at which the actual development is farthest from the desired path. Yet the weight of the different objectives for monetary policy has not merely fluctuated with prevailing economic conditions; there have also been long-term changes in these relative weights.

In general, the targets now seem to be more diverse, and the scope of monetary policy has been enlarged. Previously, monetary policy was

centred almost exclusively on the aims of maintaining adequate foreign liquidity and stable prices. Although these targets remain important, increasing emphasis is being given to foreign indebtedness, economic growth and employment.

CHANNELS

In an economy with a developed market in financial claims, it is natural to focus on interest rates or monetary aggregates as a principal channel for monetary policy. However, in an economy like Finland's there is no market in which interest rates are determined by the explicit interplay of supply and demand. Furthermore, when an attempt is made to keep the exchange rates comparatively fixed, the supply of money tends to adjust to the demand for money through the balance of payments. For these reasons it is natural that interest rates and money supply do not play a significant role as a channel of monetary policy.

In Finland, bank credit, borrowing abroad and potential borrowing power rather than holdings of money or other assets are important sources of liquidity for the corporate sector. Moreover, the banks have almost continuously satisfied their liquidity requirements by borrowing from the central bank and they are also net debtors to the foreign sector. Therefore, credit availability and credit rationing assume great importance as a channel for policy.

An essential precondition for operating on credit availability is the tendency for the demand for credit to exceed the supply at the prevailing rate of interest. In a normal excess demand situation, firms are tempted to acquire more physical capital against greater liability to banks and other creditors. This may imply a decline in the potential liquidity of a firm, for an increase in current borrowing may reduce the agent's ability to negotiate further loans in the future. It is just the regulation of this potential borrowing power which is the cornerstone of monetary policy in Finland. In this sort of economy, money is primarily held for transac-

tions purposes, and changes in liquidity are reflected mainly in variations in the indebtedness and the potential borrowing power of economic agents.

Since borrowing and assumed borrowing power from both banking and foreign sector are two of the most important sources of external finance for firms, the principal instruments of monetary policy are designed to affect credit flows from these sources. Flows of bank credit are primarily influenced by regulating the cost and availability of the credit extended by the central bank to the commercial banks, while borrowing from the foreign sector is mainly modulated by varying the selectivity with which permits to import long-term capital are granted.

Credit institutions for their part pay much attention to such characteristics as the profitability and long-term prospects of the borrower, and regulate their lending mainly by varying nonprice terms such as security, maturity and repayment schedules. Borrowers react to the changes in their borrowing power by altering their spending decisions which in turn implies change in the total demand of the economy and finally affects the ultimate goals specified to counteract the problems at hand. The effects of monetary policy in Finland are thus transmitted through the rationing of credit flows from the banking and foreign sector rather than through interest rate changes. This is naturally reflected in the nature of the monetary tools used by the Bank of Finland.

TOOLS

The monetary tools used by the Bank of Finland are basically the same as those used in other market economies, except that open-market operations have not been used in Finland. The institutional structure of the financial markets and other characteristics of the economy have, however, shaped the detailed features and relative importance of different monetary instruments.

REGULATION OF THE BANKS' CENTRAL BANK FINANCE

The control of the banks' central bank finance forms the most important weapon of monetary policy in Finland as in many other small countries. The control comprises the regulation of both the availability and the cost of central bank finance extended to the commercial banks. The right to resort to central bank finance is granted to the banks by the Board of Management of the Bank of Finland. Every commercial bank except the smallest is entitled to discount bills of exchange at the Bank of Finland. The call money market provides another channel of central bank finance as the Bank of Finland may supply funds to the market if that is required by the monetary policy being pursued. Moreover, central bank finance has been granted to the same banking institutions and, to a limited extent, the Postipankki through the Bank of Finland purchasing bonds with a repurchase obligation. The savings banks and co-operative banks may only make use of central bank finance through their central banks.

The methods used to regulate the central bank finance of the banks have varied, but certain key features have remained unchanged for years. The Board of Management of the Bank sets a credit quota for each bank, and the bank may then discount bills up to this amount at the basic rate of interest set by the Bank Supervisors. In the last ten years, this rate has been between 7 and 9¼ per cent. The banks are allowed to exceed their quotas, but a penalty rate of interest on the total amount of quota-related central bank finance is then charged in addition to the basic rate. This penalty rate increases as the bank progressively exceeds its quota. The Bank Supervisors also determine the upper limit for the penalty rate, which has been 4 per cent on the total debt.

There have been daily ceilings on the amount allowed in excess of the quotas and on the amount each bank can borrow in the call money market. Once these ceilings have been reached the banks may obtain additional central bank credit only through the temporary sale of bonds to the central bank. These transactions have

been arranged so that the price differential corresponds to a rather high interest rate.

In order to prevent excessive borrowing from the central bank in the event that the banks are willing to bear the high cost of marginal domestic finance, the central bank has set surveillance limits expressed as monthly averages. If these are exceeded, the commercial banks in question are brought under progressively stricter scrutiny by the Bank of Finland. This involves submitting detailed information on liquidity as well as on current and planned lending.

In 1977, a temporary system designed to increase the price incentive of the banks to reduce their central bank debt was in operation. It involved a special bonus scheme for those banks which met certain pre-set monthly targets concerning their use of central bank credit.

Changes in the size and structure of the quotas and in the marginal interest rate schedule on quota-related debt as well as operations in the call money market and variations in the surveillance limits have been used to affect the ability and willingness of the banks to make use of central bank finance and thus to affect economic activity through credit expansion. In order to prevent the banks from passing on the costs of central bank borrowing, the Bank of Finland has imposed a ceiling on the maximum lending rate applied by banks making use of central bank finance and monitors movements in their average lending rate.

There are weaknesses in using the regulation of the banks' central bank finance as the main weapon of monetary policy. Perhaps the greatest of these is the considerable lag before this policy instrument can affect credit expansion and total demand. The reason for this is that the banks' credits are committed fairly far into the future through promises to provide credit for their customers. The measures taken to regulate the banks' central bank finance thus primarily affect advances which are to be negotiated subsequently. Another weakness is

the fact that, being a tool of general character, the possibilities to direct the impact are rather small. This means that when regulation of the banks' central bank finance is used as a major instrument in restraining total demand, essential structural change in the economy and thus long-term economic growth may be hampered.

THE CALL MONEY MARKET

In order to improve both the efficacy of monetary policy and the functioning of the financial market, the Bank of Finland opened a call money market in 1975. The creation of an official market was designed to correct some deficiencies in the overnight transactions between banks, which banks previously used to even out their liquidity positions. Operations in the call money market influencing the cost and availability of short-term liquidity are best seen as a complement to traditional quota-policy, which, as a rule, has a longer time-horizon.

The call money market consists of accounts in the central bank into which the banks entitled to central bank finance can deposit and from which, up to a certain limit, they can overdraw. Overdrafts are granted, and deposits accepted, to the next banking day. The daily overdraft of any bank may not exceed a certain percentage of its credit quota. Postipankki (the post office bank), which is banker to the Government, has the right to use the call money market, but is not allowed to overdraw. This makes it possible to even out short-term fluctuations in commercial bank liquidity resulting from changes in the central government's financial position.

The Bank of Finland sets the call money rate within a range determined by the Bank Supervisors. In doing so, the basic principle is to equilibrate supply and demand in the market. From time to time the Bank has also intervened in the market by placing funds into it or absorbing funds from it.

By participating in the market, the Bank of Finland can on the one hand soften the immediate effect of changes in quotas on the liquidity of the banks and on the other hand affect the

cost level of central bank financing. By changing the maximum allowable daily overdraft the Bank can adjust the capacity of the market to accommodate short-term fluctuations in liquidity in the banking sector.

CASH RESERVE DEPOSITS

In Finland the banks have not been obliged, either by law or custom, to keep permanent cash reserves with the Bank of Finland. To even out cyclical fluctuations, the Bank of Finland and the banking institutions have occasionally agreed to create temporary cash reserve deposits: a law came into force at the beginning of 1966 that allows the Cabinet, together with the central bank, to compel the banks temporarily to deposit cash reserves. The law can be invoked if no voluntary agreement is reached.

Both the legislation and all agreements made so far have been based on the principle that a bank's obligation to deposit cash reserve depends on the growth of its deposits. The law sets upper limits for this obligation, and these limits have never been exceeded in the agreements. Only time deposits are covered by the law, but demand deposits have been included in the agreements.

The use of the cash reserve deposit system together with regulation of the banks' central bank credit has proved useful as far as the former directly affects the credit-granting possibilities of the savings and co-operative banks as well as those of the commercial banks and Postipankki. Otherwise the cash reserve deposit system shares the disadvantages of controlling credit-granting through the regulation of the banks' central bank credit.

DOMESTIC NON-BANK LENDING

The Bank of Finland has also satisfied the need for central bank credit by direct lending to various sectors of the economy. The main rationale in channelling funds to the business sector, either directly or via special credit institutions, has been to promote structural change in the economy. The Bank has tried to

increase the selectivity of monetary policy in order to allow for long-run allocative considerations even under tight cyclical conditions. Direct lending has also been used for evening out cyclical variations. There are, however, no permanent lending facilities for this purpose.

The central bank has not been a source of finance for the State. The only major post-war exception to this rule was in the late 1960s, when the Bank granted a three-year loan to the Government.

Direct lending to firms mostly takes the form of permanent special credit arrangements made in co-operation with the banks. Arrangements such as suppliers' credits, short-term export credits and the so-called »new export» credits have been created in order to secure finance for sectors which diversify the structure of production and are important for the balance of payments.

Another way that has been used to channel central bank finance to the business sector is the special credit institutions such as the Mortgage Bank of Finland Ltd and the Industrialization Fund of Finland Ltd. This possibility has been used to some extent as a tool of structural policy. The use of this type of financing to implement counter-cyclical policy is restricted by the relatively limited capacity of these institutions to channel credits which arises partly from the very nature of their activities.

Lending to business firms for cyclical reasons has taken place only rarely and has been mainly motivated by a severe decline in export demand, which has led to unusually large stockpiling and cuts in production and employment. Temporary financing has been granted in the form of the Bank's own lending or by allowing capital imports.

INTEREST RATE POLICY

Over the last twenty years interest rate policy has played only a minor role in Finnish monetary policy. The rigidity of this component of monetary policy can be attributed mainly to the harmful side-effects which are imputed to

rises in the interest rate level. Therefore, there usually have been difficulties in finding the necessary political support for interest rate policy measures which are decided upon by the Bank Supervisors.

The fact that most claims in the Finnish financial market bear a variable rate of interest which is, as a rule, tied to the rate paid on deposits, means that a change in interest rates has an especially great effect on costs, prices and income distribution. On the other hand, the prevailing interest rate level does not greatly affect the timing of investment projects, because with variable interest rates the cost of the investment depends on the average interest rate over the whole credit period and not on the rate applied at the time the credit is negotiated.

In light of the average rate of inflation, the interest rate level has obviously been very low in Finland. This, together with taxation which favours capital-intensive investment, has undoubtedly channelled finance to projects which are too capital-intensive. The low interest rate level may also partly explain a capital-output ratio which is high in comparison with that in many other countries. It would seem that all these factors contribute to the tendency towards excess demand and disequilibrium in the balance of payments.

On the basis of the recommendations of the Bank of Finland, the banks carry out interest rate differentiation according to the activity of the borrower or the purpose of the loan. The highest rates are charged on credits granted for consumption and the import of consumer goods and the lowest rates on those for export and import substituting production. The aim of this kind of differentiation has been to encourage activities considered important and to restrain those held to be less valuable.

Although short-term international capital movements related to commercial transactions, unlike long-term capital movements and short-term financial credits, are, within rather broad central bank regulations, automatically allowed, the effects of differences between domestic

and foreign interest rate levels do not seriously limit the pursuit of an independent interest rate policy. This can be partially explained by the fact that the mark is not a currency used internationally.

CREDIT POLICY GUIDELINES

The Bank of Finland has issued guidelines to the banks advising them of the anticipated course of monetary policy and recommending that certain types of activities be favoured or disfavoured. These guidelines have in most cases been fairly general, but at times detailed directives have also been given, especially on the granting of personal credits. However, there has been no way of assuring that the guidelines, particularly the more general type, will have the desired effect on the banks' lending policies. On the other hand these guidelines, due to their publicity, are to some extent effective in shaping the general economic climate.

COUNTER-CYCLICAL ARRANGEMENTS

General fiscal and monetary policy measures have been supplemented by counter-cyclical policy instruments. In this context, the measures which are closely connected with the Bank of Finland's monetary policy are discussed. In practice and often also formally, the Bank has a part in the decision-making process concerning their use.

The government's counter-cyclical fund, the law for which came into force in 1970, enables the transfer of state funds to a special counter-cyclical account at the Bank of Finland. A parliamentary decision is needed to make transfers to or withdrawals from the fund. An official statement from the Bank of Finland is required before a proposal on an increase in or use of this fund can be made. A certain rigidity in the decisionmaking process is a drawback of this facility.

The selling of certificates of deposit was used extensively at the beginning of the 1970s in order to freeze liquidity in the central bank. According to the Regulations for the Bank of Finland, these certificates of deposit can be sold

only with the permission of the Bank Supervisors which can be granted only for a set period. Certificates of deposit have proved to be a very flexible and useful monetary instrument.

In the investment deposit system, firms are encouraged by tax concessions to deposit with the Bank of Finland during economic upswings a portion of the funds transferred in their accounts to a special investment fund. The funds are then released during the following recession. No great use has, however, been made of this system, because apparently it has not been attractive enough for the firms.

After the devaluation of the Finnish mark in 1967 an export levy was imposed, the receipts from which were placed on a special account with the central bank and used through the State budget for the development of the economy's productive capacity. During 1969—1970 there were voluntary agreements between the State and various industrial organizations about collecting counter-cyclical deposits at the Bank of Finland, which were later returned to the firms. In addition, a counter-cyclical export tax system was passed at the end of 1970. These were made on a temporary basis in order to supplement investment deposit and export levy systems.

A permanent export levy was enacted in 1974, under which export levies are charged if export prices rise at an exceptionally high rate, but it cannot be used to cut normal cyclical variations in export earnings. Half of the levies are to be transferred to the government's counter-cyclical fund and the other half returned to the firms. The law has not been used, but its existence contributed to an agreement on voluntary counter-cyclical withholdings being concluded in 1974 between the State and the Central Association of Forest Industries.

It is obvious that counter-cyclical measures based on sporadic or temporary legislation and voluntary agreements cannot be effective enough. The trend has been to establish and develop permanent instruments, which can be implemented rapidly or automatically.

OTHER MONETARY POLICY INSTRUMENTS

Bank lending has also been regulated by ceilings which have been specified in different ways — in terms of the increase in deposits or as absolute growth limits. For the commercial banks the ceilings have been integrated with the conditions governing their use of central bank finance, and varying modes of sanction or bonus have been linked to the system. To other banks covered by the system, the ceilings have been given as recommendations. The primary problem faced in all cases is the difficulty of determining in advance the proper height for such ceilings.

The central bank can effect the issuing activity of Finnish banks, firms and local authorities, since a statement from the Bank of Finland is needed before the Cabinet can grant a permit to issue domestic bonds. If the Bank opposes an issue, the permit cannot be granted.

At times the Bank of Finland has collected capital import deposits. The principal purpose of this system has been to dampen the liquidity effects where a major loan is taken up in large installments, but required only gradually as the investment involved advances. Import deposit and cash payment obligations related to commodity trade are other schemes of a temporary nature which have been used. The purpose of these schemes have been to put importers of certain commodities in a financial position somewhat similar to that of those operating in the tight domestic market when the Bank of Finland has recommended banks to dis-favour that kind of demand in their lending activities.

The regulation of hire-purchase terms by the Cabinet in concert with the Bank of Finland has to some extent been used to influence demand for major durables, especially cars. However, trade financed through hire-purchase has never been very significant in Finland. As it has also been very difficult to see that the stipulations on hire-purchase are followed, this weapon has not been considered especially useful.

Excess demand for finance is reflected in a net inflow of foreign capital. In Finland long-term foreign credits have been a significant source of finance for investment. Thus the efficacy of monetary policy measures proper in influencing domestic demand, can be considerably increased by regulating capital movements. Short-term capital movements related to commercial transactions are allowed for under a general permission given by the Bank of Finland. Specific permission is needed for other short-term and all long-term transactions.

In order to facilitate a consistent co-ordination of central bank measures regulating sources of finance to the private sector, the Bank of Finland makes use of a financial framework, in which net inflow of foreign capital together with net lending by the central bank are strategic aggregates. An analytical deficiency of this approach is, however, the difficulty of quantifying the proper amount of total foreign borrowing that, together with other sources of external finance, is compatible not only with a certain balance-of-payment target but also with all the objectives of monetary policy.

Another weakness is the practical difficulty of reaching the target set for capital imports. Trade credits are sometimes subject to rather strong and unpredictable fluctuations. Discrepancies between targets and outcomes occur also in those capital flows which are directly controlled by the Bank of Finland as these flows are influenced by the availability and terms of borrowing in international capital markets. The importance of international capital movements makes it essential to closely co-ordinate monetary policy proper and the regulation of these movements.

SCOPE

The tools of monetary policy available to the Bank of Finland have somewhat one-sided effects, especially if interest rate policy is not used. In this case monetary policy affects mainly investment and firms in general. The

monetary instruments have also been to some extent asymmetrical in the sense that they have been of help during restrictive periods, but of limited use for economic revival.

Another weakness of these instruments is that the time lags required for the measures to take effect are probably fairly long, although their exact length is not known. Because of those time lags, monetary measures require to be implemented early, so in most cases policy must be formulated on the basis of forecasts. The continuous improvement in the reliability and time horizon of economic forecasts is thus essential for improving the timing of monetary policy.

A third limitation of monetary instruments in Finland is the weakness of their effects. Although no reliable measurements of the effects are available, it is difficult to avoid the impression that the results, especially in the field of counter-cyclical policy, have been modest in light of the amplitude of cyclical swings in the Finnish economy. The weakness is not necessarily a result of the meagreness of the theoretically achievable effect, but rather of the fact that a strong counter-cyclical policy cannot be pursued unhampered with such a one-sided set of instruments as is available to Finnish monetary policy. It is an open question whether or not better timing alone would produce better results.

Taking into account the one-sidedness and asymmetry of the monetary policy instruments, the length of the time lags and the weak impact that can be reasonably aimed at, it is clear that the objectives of economic policy can be reached only to a limited extent with monetary policy alone. A co-ordinated mix of both monetary and fiscal measures should make it possible to more fully achieve the goals.

If better results are to be attained through monetary policy and through economic policy in general it is essential that the tools of monetary policy as well as the planning of their use be continuously improved. In this context attention must be given to the co-ordination of monetary and fiscal policy.

BANK INSPECTION IN FINLAND

by Jussi Linnamo

Chief Director of the Bank Inspectorate

Revised banking legislation came into force in Finland at the beginning of 1970 (See Bulletin No. 1/1970). The Bank Inspectorate, which supervises the activities of commercial, savings and co-operative banks, mortgage credit institutions and credit companies was re-organized at the same time. The security funds of the banks, the purpose of which is to secure the claims of depositors, are also supervised by it. The separate inspection boards of the savings and co-operative banks are also subordinate to the Bank Inspectorate. The Bank Inspectorate not only ensures that the banks observe the law and their regulations but also grants permits for certain banking activities which require specific authorization. In addition, it has the right to make proposals to the Government and Ministry of Finance on the development of banking and on the promotion of competition within the banking sector. The Bank Inspectorate is subordinate to the Ministry of Finance.

HISTORICAL DEVELOPMENT

When commercial banking activity began in Finland, the Senate (later the Cabinet) appointed supervisors to the boards of management of the commercial banks. However, it was deemed necessary to unify the supervision of the commercial and mortgage banks by establishing a special supervisory body. Thus the first Bank Inspectorate was founded in 1922. The savings banks have been subject to inspection since 1895. An official of the Ministry of Finance served as inspector until 1939 when a special savings banks' inspection board was set up in the Ministry. This body discontinued its activities in 1954 as the Finnish Savings Banks' Association set up its own inspectorate, which, however, was required to function under the supervision of the Ministry of Finance.

The co-operative credit societies (the present co-operative banks) have been supervised by the Co-operative Bank Inspection Board since the 1920's. Before the revision of banking law in 1970, this board was not subordinate to any central government organ.

The credit companies and the banks' security funds have been supervised only by auditors appointed during the annual meetings.

In the course of time the application of law by the various supervisory organs became so divergent that the re-organization of the Bank Inspectorate was deemed necessary.

ORGANIZATION AND DECISION-MAKING

In the Bank Inspectorate decisions are taken jointly in a governing body, which is made up of the Chief Director and the Chief Inspectors who serve as heads of department. The Chief Director and at least two Chief Inspectors must be present for a decision to be taken, and decisions are based on plurality of votes. Subjects dealt with include general guidelines and instructions for the Bank Inspectorate, matters of basic nature concerning more than one department, the budget, and statements to be submitted to the Cabinet or various Ministries, and certain personnel policy questions.

The departmental organization of the Bank Inspectorate reflects the institutional structure of Finnish banking. The commercial bank department deals with matters relating to commercial banks and their security funds, mortgage banks, and credit companies. This department at present also decides on the principles to be applied in the banks' accounting systems and keeps the books of the Bank Inspectorate.

The savings bank and co-operative bank departments take care of these banks and their security funds. In addition, it supervises the inspection boards appointed by the central associations of these banks. At present the co-operative bank department discusses legislative and disciplinary matters and the savings bank department has been entrusted with personnel and training policies.

On the basis of special legislation, the Bank Inspectorate also controls the payment of stamp duties on professional security transactions which take place outside the stock exchange.

SUPERVISION OF BANKS

The credit institutions supervised by the Bank Inspectorate are obliged to submit reports regularly on their activities. In addition, the Bank Inspectorate carries out actual inspections. The reports must include the balance sheet, profit and loss account and the auditors' report, and statements on cash reserves, solvency and holdings of shares and real estate. Moreover, the reports must contain minutes of the shareholders' meetings and of the annual meetings, as well as of the meetings of administrative councils or the trustees. Some information on trustees and members of administrative councils, etc., managers and certain other employees is also required. The banks are obliged to inform the Bank Inspectorate of the temporary ownership of property by them because of default on a loan, and of the opening of new branches. The Bank Inspectorate has to be notified if one person or a group of persons whose financial interests are essentially identical has been granted an amount of credit which can be regarded as endangering the solvency of the bank. On the basis of this information the Bank Inspectorate is able to follow the banks' operations. In this, automatic data processing is used as much as possible.

A representative of the Bank Inspectorate has the right to be present at the meetings of the

shareholders or the administrative councils or corresponding organs of credit institutions and at the auditing of the books. The Bank Inspectorate may also call meetings of the various organs of authority.

Inspection of the commercial and mortgage banks, credit companies and the banks' security funds by the Bank Inspectorate takes place at least every second year. The inspection may be either partial or complete. The banks are informed of the results and at the same time advised to remove any defects within a set period.

The savings and co-operative banks have to be inspected every second year by their own inspectorates. These inspections may also cover either a part or all of their activities. The inspection of these banks by the Bank Inspectorate may take place for special reasons arising e.g. from the bank's report to the Inspectorate or the need to clarify the nature of competition between banks in a community. In the latter case it is usual to inspect every bank in the community. If it is deemed necessary the Bank Inspectorate may also inspect the branches of savings or co-operative banks.

It is an integral part of the inspectors' work to rectify inaccuracies or defects in the banks' reports to the Bank Inspectorate and to consult the banks on any relevant matters.

SANCTIONS USED IN INSPECTION

In case the credit institutions break the law, the articles of association of a company or their own regulations the Bank Inspectorate may resort to various sanctions. The mildest of these is an oral or a written admonition. The Bank Inspectorate is also entitled to cancel a decision made in the shareholders' or a corresponding meeting or prevent the execution of a decision made by an administrative council or a board of management, if it contravenes the law or the bank's regulations and order rectification.

If a member of some administrative body or his alternate, an employee responsible for the bank's activities, or an auditor has failed to observe the law, the articles of association of a company or other regulations, the provincial government may, at the suggestion of the Bank Inspectorate, oblige him to fulfil his duties. If a bank which is supervised by the Bank Inspectorate is not properly run, an official may be appointed to supervise its activities.

If depreciation on real property or allowances for bad debts are not considered adequate by the Bank Inspectorate, the Ministry of Finance may, at the suggestion of the Bank Inspectorate, limit the distribution of dividends or prevent the use of the annual profits for purposes other than increasing the bank's reserve funds.

If a bank has illegally bought its own shares, acquired real estate or shares in corporations involved in businesses other than banking, or has failed to liquidate the property which it has acquired, the Bank Inspectorate is bound to inform the Ministry of Finance. After the bank in question has been given the opportunity to explain the situation, the Ministry will make arrangements for the liquidation of the property for the bank's account.

In case of severe violation of the law, articles of association or other rules, or if there is reason to believe that the activities of some bank may be detrimental to the common welfare, the Bank Inspectorate must propose the cancellation of the bank's licence by the Ministry of Finance.

If a bank finds that its solvency ratio does not fulfil the requirements of the law or that it is not able to meet its commitments, it is the Bank Inspectorate's responsibility to arrange the closing of the books of the bank. If, as a result of this, the bank's future activities cannot be continued with the support of the bank's security fund or any other legally accepted means, the management must notify the Ministry of Finance. The Ministry may then

require that acceptance and repayment of deposits be discontinued either partially or totally for four months. By the end of this period the bank must submit a proposal to the Bank Inspectorate of how it plans to safeguard its activities in the future. Upon acceptance of the suggestion the bank has to apply to the Ministry of Finance for the withdrawal of the decision to suspend the bank's activities. Otherwise the bank has to be put into a state of liquidation. At least one of the receivers must be appointed by the Bank Inspectorate.

If the Bank Inspectorate deems that it is in the depositors' interest, it may initiate court action against those who represent the bank. The Bank Inspectorate may also turn to the public prosecutor in order that legal action be taken against any official of the bank who has broken bank secrecy.

LICENCES GRANTED BY THE BANK INSPECTORATE

Permits for the banks to establish new branch offices are granted by the Bank Inspectorate. It also authorizes the banks to carry out the activities of real estate agents in connection with schemes designed to facilitate home ownership. The banks which would like to invest a greater share of their total assets in real estate than is permitted may be granted exemption by the Bank Inspectorate.

The Inspectorate may authorize a bank, which has acquired as an indirect consequence of its activities ownership of some property, the right to hold this for a certain period. Moreover, a bank may be given the right to stay below the required solvency ratio or to include its debentures in its own funds.

The Bank Inspectorate sets the general limits for the activities of the banks and their trustee departments. It also sets the upper limit on total credits to be granted to one and the same person without guarantee.

The Bank Inspectorate sanctions the regulations of the inspectorates of the savings and co-operative banks and confirms the election of their inspectors.

EXPENDITURE OF THE BANK INSPECTORATE

The credit institutions must defray the costs of the activities of the Bank Inspectorate, and the amount which each bank must pay annually is

determined by the Ministry of Finance. When the costs incurred are distributed among the various groups of banks the work caused by each of them is taken into account. Each bank is charged on the basis of its total assets at the end of the previous calendar year. Responsibility for the collection of payments rests with the Ministry of Finance which acts on the basis of information provided by the Bank Inspectorate. The latter also confirms the principles behind the charges of the inspectorates of the savings and co-operative banks.

THE FINNISH COMMERCIAL BANKS

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HISTORICAL BACKGROUND AND NATURE OF COMMERCIAL BANKS

As industry and commerce started to expand in the middle of the 19th century, the establishment of commercial banks — an idea that had been previously considered — became possible. The first Finnish commercial bank was founded in 1862 (Suomen Yhdyspankki — Föreningsbanken i Finland). By the turn of the century nine commercial banks had started operations. The number reached its maximum in 1920; at that time 25 commercial banks were in operation. Altogether 39 commercial banks have existed in Finland, including those functioning at present.

A high proportion of Finnish commercial banks have been rather short-lived. In 1933 there were again only nine commercial banks. However, only five commercial banks have ever gone bankrupt, while 27 have discontinued operations because of a takeover by another commercial bank or through the merger of two or more banks to form a new commercial bank. As a result, commercial banking is more heavily concentrated in Finland than in other Nordic countries or in the Western World in general.

A joint stock company is the sole legal form for a commercial bank. This means, in practice, that where there are no regulations for commercial banks, they follow the provisions laid down for joint stock companies. The joint stock company was the legal form actually adopted by the first Finnish commercial bank, although no law on joint stock companies, let alone commercial banks, existed at that time. The present law governing commercial banks was enacted in 1969.

The highest decision-making authority in a commercial bank is the stockholders' meeting; this chooses the supervisory board, which in turn selects the board of management of the bank. The members of both these bodies have to be Finnish residents living permanently in the country. Also, none of the stockholders can use a voting right exceeding 1/20 of the total votes represented in the stockholders' meeting.

The main task of the supervisory board is to supervise the operations and management of the bank. In addition, it appoints the members of the board of management, decides on the establishment and closing-down of branch offices, the selling and buying of real estate, etc. The board of management is responsible for the general management of the bank in accordance with the law, the bank's articles of association and the decisions of the stockholders and the supervisory board.

THE STRUCTURE OF THE COMMERCIAL BANK SYSTEM

At the beginning of the 1960s only five commercial banks were in operation: Kansallis-Osake-Pankki (KOP), Pohjoismaiden Yhdyspankki Oy — Nordiska Föreningsbanken Ab (PYP — NFB) (since 1975, the Union Bank of Finland Ltd (SYP — FBF), Helsingin Osakepankki — Helsingfors Aktiebank [The Bank of Helsinki Ltd (HOP — HAB)], Ålands Aktiebank (ÅAB) and the Central Bank of the Savings Banks (SKOP). Since then, however, the number of commercial banks has increased by two. In 1963 Peruspankki Oy was founded with the support of the trade union movement.

At the beginning of 1970, the Central Bank of the Co-operative Banks (OKO) was transformed into a commercial bank on the basis of the new bank legislation. At present, there are thus five actual commercial banks and two banks that act as the central banks of their own institutional groups. Of the first five, only three are in fact spread all over the country, for one of them, Ålands Aktiebank, which operates in the archipelago of Åland — Ahvenanmaa, is a distinctly provincial bank and Peruspankki Oy operates from only one office. The two largest commercial banks account for approximately three-quarters of the total business of commercial banks in Finland.

Despite the fact that commercial banking is very concentrated, the number of branch offices has continuously increased. This can be partly explained by geographical factors, the collection of deposits by the commercial banks and by competitive considerations. A great number of branches is necessary, not only because the country is large and sparsely populated in many areas, but also because the banks collect their funds mainly in the form of rather small deposits from all over the country. In population centres, on the other hand, new branches have, especially in the 1960s, been founded because new types of banking services have been introduced and banking activities in general have expanded. The branches of the commercial banks accounted for approximately 13 per cent of the total number of bank offices in the whole country at the end of 1969, including the branches of Postipankki.

At the moment, the commercial banks employ more than 16 000 people, of whom roughly three-quarters are women. The following table gives the number of employees as well as the number of commercial banks and their branch offices at the end of 1965 and 1975.

	Dec. 31, 1965 ¹	Dec. 31, 1975 ¹
Number of commercial banks	6	7
Number of their branches	747	871
Number of employees	8 488	16 334

¹ The Central Bank of the Co-operative Banks is included.

THE NATURE AND EXPANSION OF COMMERCIAL BANK ACTIVITIES

Like commercial banks abroad, the Finnish commercial banks try to provide as good a range of banking services as possible and have specialized primarily in serving industry and commerce. However, the emphasis between various activities may vary considerably from one country to another. The following analysis of the Finnish commercial banks' activities is based on their balance sheet totals and their breakdown into various types of assets and liabilities.

SOURCES OF FUNDS

We shall first review the liabilities side of the balance sheet in order to identify the sources of commercial bank funds.

TABLE 1. BREAKDOWN OF THE COMMERCIAL BANKS' TOTAL LIABILITIES

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Deposits made by the public	3 825.8	62.9	15 206.2	45.8
Liabilities to the Bank of Finland	513.5	8.4	3 487.5	10.5
Liabilities to other domestic banks	424.1	7.0	2 979.3	9.0
Foreign liabilities	446.0	7.3	4 456.6	13.4
Domestic liabilities in foreign currency	—	—	909.1	2.7
Capital accounts	412.0	6.8	1 952.2	5.9
Other liabilities	461.8	7.6	4 238.6	12.7
Total	6 083.2	100.0	33 229.7	100.0

Total commercial banks' liabilities amounted to 33 230 million marks at the end of 1975, or 34 per cent of the GDP at 1975 market prices, while the corresponding figure for 1965 was approximately 24 per cent.

The major part of the commercial banks' funds is collected in the form of deposits from the public. The Finnish commercial banks can thus be characterized by the international term »deposit bank». However, the share of deposits in total liabilities has declined from 63 per cent in 1965 to 46 per cent in 1975.

The lasting indebtedness of the commercial banks to the central bank is a characteristic, if not an institutional feature, of Finnish banking. It is a sign of the scarcity of credit, the demand for which is usually considerably greater than supply. The degree of this »illiquidity», of course, varies to some extent with, for example, cyclical developments. The table above reveals that at the end of 1975 the liability of the commercial banks to the Bank of Finland accounted for about 10 per cent of their total liabilities and that ten years earlier the corresponding figure was 8 per cent.

Liabilities to the other domestic banks were 7 per cent in 1965 and in 1975 approximately 9 per cent of total liabilities and therefore quite considerable. Much of this is accounted for by the liquid reserves held by the savings and co-operative banks in their own central banks, which are included with the commercial banks. In the last few years, short-term credits obtained from the other banks have, at times, also played a significant role. Excluding the central banks of the savings and co-operative banks, such credits, however, did not total more than 2 per cent of the commercial banks' total liabilities.

Foreign liabilities increased from 7 to 13 per cent of the total liabilities from 1965 to 1975. This item is not an accurate reflection of the importance of the commercial banks' foreign transactions which form an essential part of their activity. They are fully authorized foreign exchange banks, through which almost all payments for trade abroad and other foreign transactions take place.

Domestic liabilities in foreign currency — nearly 3 per cent of the balance sheet total in 1975 — are almost entirely composed of the foreign exchange deposits made by domestic enterprises and private persons. Capital accounts totalled 6.8 per cent in 1965 and 5.9 per cent in 1975 of the commercial banks' balance sheet total. The acquisition of funds in the form of share capital is expensive, partly for tax reasons. Therefore, share issues are usually only effected to maintain the solvency require-

ment stipulated by law. According to the law regulating commercial banks a commercial bank's capital accounts have to amount to not less than 4 per cent of its total liabilities (excluding certain items). It has to be borne in mind that banks usually have considerable »hidden reserves» apart from the capital accounts appearing in the balance sheet.

TABLE 2. DEPOSITS MADE BY THE PUBLIC, ACCORDING TO TYPE OF DEPOSIT

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Demand deposits				
(cheque accounts)	665.7	17.4	3 159.1	20.2
Time deposits				
(deposit and savings accounts)	2 234.2	58.4	7 438.3	47.5
Term deposits	925.9	24.2	5 050.6	32.3
Total	3 825.8	100.0	15 648.0	100.0

The above table illustrates the composition of deposits made by the public. As already mentioned in the first article of this booklet, the ratio of demand deposits to all bank deposits has always been small in Finland. At the end of 1965 this figure in the commercial banks was 17 per cent and ten years later 20 per cent. Commercial banks hold nearly $\frac{3}{4}$ of all demand deposits (including postal giro accounts).

The most popular deposit account with the commercial banks — and in Finland in general — is the deposit or savings account which at the end of 1977 yielded an interest rate of $4\frac{1}{4}$ per cent. It is tax exempt and an amount of 5 000 marks can be drawn from this account monthly without notice. The share of this type of deposit in total deposits of the commercial banks has been nearly 50 per cent in the last few years; in 1975 47.5 per cent. This item includes a small number of deposit accounts with cheque facility.

Term deposits were roughly 32 per cent of total deposits of the commercial banks at the end of 1975. At the end of 1977, there were five types of such deposits: 6-month deposits yielding an interest rate of $5\frac{1}{4}$ per cent, 12-month $6\frac{1}{2}$ per cent, 24-month $7\frac{1}{2}$ per cent, 36-month $8\frac{1}{4}$ per cent plus a savings premium

and 36-month 8 ¼ per cent plus a tax concession benefit. The index-tied deposits, which were of great significance in the 1950s and 1960s, have been abolished.

There is no detailed information on the distribution of the depositors according to various population groups. Cheque accounts yielding no interest, however, belong exclusively to the business sector. The major part of time deposits and term deposits are held by households.

ALLOCATION OF FUNDS

In the above, the sources of commercial bank funds were described. The way in which these funds are invested will now be dealt with; again, the basis of this analysis is the balance sheet of the banks.

TABLE 3. BREAKDOWN OF THE COMMERCIAL BANKS' TOTAL ASSETS

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Loans to the public	4 279.6	70.3	17 761.3	53.5
Shares and bonds	421.8	6.9	2 662.0	8.0
Cash	166.1	2.7	521.3	1.6
Foreign assets	388.7	6.4	1 495.4	4.5
Domestic assets in foreign currency	—	—	3 586.4	10.8
Claims on other domestic banks	275.2	4.6	2 542.4	7.7
Real estate	121.5	2.0	1 071.9	3.2
Other assets	430.3	7.1	3 589.0	10.7
Total	6 083.2	100.0	33 229.7	100.0

The major item in commercial bank lending is loans granted to the public, which accounted for 53.5 per cent of all the assets of these banks at the end of 1975, the corresponding figure having been 70 per cent ten years earlier. Domestic assets in foreign currency, an item not entered separately in 1965, amounted to 11 per cent of all assets in 1975. These assets form a part of loans granted to the public; e.g. funds accrued as foreign credits or deposits are usually channelled to domestic customers.

Shares and bonds have not played any marked role in the activity of the Finnish commercial banks. Legal restrictions prevent the commer-

cial banks from engaging in industry or similar activities, which do not fall within the strict banking sphere. The banks are allowed to own up to 20 per cent of the total capital stock of companies engaged in this type of business. In addition, a bank cannot invest more than 10 per cent of its capital accounts in industrial shares. The greater part of the shares held by banks are shares of real estate companies which have been purchased to provide branch offices.

The banks' portfolios of bonds are also small, which reflects the underdeveloped nature of the Finnish bond market as a whole. The purchase of government bonds by the commercial banks is not extensive, and the same can be said of privately issued bonds, for issues of these have not been very large. The Industrial Mortgage Bank of Finland Ltd, which is owned by the commercial banks, makes bond issues regularly both in Finland and abroad. Since the Finnish bond market is so limited, most of the domestic bonds find their way to the commercial banks' portfolios. Therefore, these bonds only form a kind of indirect channel by means of which the banks grant credit to their own customers. In addition, the banks purchase, by standing arrangements, debentures from the 'Finnish Export Credit Ltd and the Industrialization Fund of Finland Ltd, in which the commercial banks are shareholders.

The banks hold cash only to the extent that they need it for their daily transactions. Such cash usually accounts for about 2 per cent of a bank's total assets. Legally the cash forms a part of a bank's liquid reserves, which have to total 20 per cent of its sight liabilities and 5 per cent of other liabilities.

Foreign assets were slightly less than 5 per cent of the balance sheet total in 1975, the corresponding figure in 1965 having been 6 per cent.

Claims on other domestic banks accounted for as much as 8 per cent of total assets in 1975. These items, however, consisted almost exclu-

sively of credits granted by the central banks of the savings and co-operative banks to their member banks.

The commercial banks obviously need to own real estate for their branch offices. These holdings account for about 3 per cent of their assets.

The distribution of credits granted to the public according to sector completes the picture of the commercial banks' field of activity. Table 4 gives such a classification for 1965 and 1975.

Credits granted by the commercial banks totalled 21 136 million marks at the end of 1975, which was nearly one third of the total recorded credit granted in the country. The distribution of credits according to sector has continuously changed and been diversified in line with the structural change of the economy.

TABLE 4. CREDITS GRANTED TO THE PUBLIC, BY SECTOR

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Agriculture, forestry and fishing	163.2	3.8	424.8	2.0
Manufacturing, mining and quarrying	1 427.1	33.2	7 511.3	35.5
Electricity, gas and water	37.7	0.9	249.0	1.2
Construction and real estate	575.9	13.4	2 306.0	10.9
Trade, communications and other service industries	1 165.4	27.0	5 053.4	23.9
Municipalities and parishes	118.7	2.8	820.4	3.9
Personal and miscellaneous credits	812.6	18.9	4 770.6	22.6
Total	4 300.6	100.0	21 135.5	100.0

The largest borrower has been manufacturing, mining and quarrying; its share exceeded 35 per cent of total credits in 1975. The service industries, trade and communications at the same time took 24 per cent of all commercial bank credit. These two groups are clearly the leading recipients of commercial bank lending. In 1975, commercial bank credit was 39 per cent of all industrial credit. Of the credit

granted to trade, communications and other service industries 44 per cent was raised from the commercial banks. Both shares have been declining during the last decades.

The greatest increase in lending over the period 1965—1975 occurred in personal and miscellaneous credits. The share of these credits in total commercial bank lending increased from 19 per cent to 23 per cent. This is due to the fact that competition between the banks has been greatly increasing and long-standing customers have been readily granted credit. Most personal credits are used for housing purposes.

The share of construction and real estate decreased from 13 per cent in 1965 to 11 per cent in 1975. These credits are granted either to contractors or real estate companies.

The share of agriculture, forestry and fishing in commercial bank lending has always been relatively small: in 1975 it was 2 per cent, which was only one twelfth part of this sector's total bank credits. Municipalities and parishes have been in roughly the same position. The smallest share has been taken by electricity, gas and water, which is natural because this sector primarily needs long-term finance which is not provided by the commercial banks.

TABLE 5. CREDITS GRANTED TO THE PUBLIC, BY TYPE OF CREDIT

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Bills of exchange	1 434.5	33.5	3 043.3	14.6
Loans (granted against promissory notes)	2 541.6	59.4	16 908.9	81.3
Overdrafts (cheque accounts)	303.5	7.1	847.1	4.1
Total	4 279.6	100.0	20 799.3	100.0

The structure of lending by type of credit has changed considerably during the ten years under review. Only three forms of credit are used in Finland, namely bills of exchange, loans granted against promissory notes and overdrafts. In 1965 as much as 33.5 per cent of total lending was in the form of bill credits,

Short-term credits, including overdrafts, totalled 41 per cent of total credits granted to the public. The share of loans given against promissory notes, which was 59 per cent in 1965 increased to 81 per cent by the end of 1975. By the same date, bill credits totalled no more than 15 per cent and short-term credits only 19 per cent of total credits.

This development has, to some extent, involved a lengthening of business credit; credits granted in the form of bills of exchange, which should have been short-term, usually for 3 months, were in practice rather longer term because they were constantly renewed. Thus, the relative increase in the proportion of loans in total credit probably does not mean a lengthening of the real average loan period. The loans are seldom granted for a period longer than five years and usually bear one month's term of notice.

Bill credit is subject to a greater stamp duty than other forms of credit, which is probably one explanation for the relative decline in the share of bill credit in total credit. This tendency may continue in the future, for, since 1970, even the commercial banks have not been required to rediscount when drawing credit from the central bank. The Bank of Finland grants the major part of its credit to the commercial banks against the banks' own bills of exchange.

It is Finnish practice for bank guarantees to be shown outside the balance sheet. The guarantees, however, play an important role in the commercial banks' obligations. At the end of 1975 bank guarantees totalled more than 19 000 million marks, which is more than the total amount of credit granted to the public.

REVENUE AND EXPENDITURE OF FINNISH COMMERCIAL BANKS

The major items of revenue and expenditure for the commercial banks are interest yields from lending and interest payments to depos-

itors. Interest and commission account for more than three quarters of total revenue. There have been no marked changes in the revenue structure during the period under review. The share of interest income was 90 per cent in 1975 and is more dominant than earlier.

TABLE 6. DISTRIBUTION OF THE COMMERCIAL BANKS' REVENUE AND EXPENDITURE

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Revenue				
Interest income and commission on lending	339.4	79.1	2 470.9	78.8
Interest income and commission on other investment	30.8	7.2	360.6	11.5
Profit on foreign exchange	18.6	4.3	185.8	5.9
Other revenue	40.2	9.4	118.0	3.8
Total	429.0	100.0	3 135.3	100.0
Expenditure				
Interest expenses	209.5	48.8	1 737.9	55.4
Salaries	97.7	22.8	525.5	16.8
Taxes	32.2	7.5	171.3	5.5
Depreciation	10.8	2.5	92.2	2.9
Other expenditure	51.4	12.0	425.2	13.6
Profit for the year	27.4	6.4	183.2	5.8
Total	429.0	100.0	3 135.3	100.0

In the composition of expenditure, the share of interest expenditure has varied quite substantially, being 55 per cent in 1975 against 49 per cent in 1965, which is mainly due to the fact that commercial banks have used considerable amounts of the relatively expensive central bank credit. Salaries account for 17 per cent of all expenses but the share has been decreasing at the same time as more has been spent on automation.

In a sparsely populated country like Finland, the improvement and maintenance of branches require much investment. Thus institutional factors have had an important role in the determination of the structure of revenue and expenditure of the commercial banks. The relative share of the annual profits entered in the income statement is about 6 per cent. The dividends, however, have been kept rather high, exceeding 10 per cent for most banks.

TABLE 7. AVERAGE LENDING AND DEPOSIT RATES OF INTEREST AND THE DIFFERENCE BETWEEN THEM ¹

	Dec. 31, 1965	Dec. 31, 1975
	Per cent	
Average lending rate of interest	7.39	9.77
Average interest rate on deposits	3.59	5.30
Interest margin	3.80	4.47

¹ Excluding the Central Bank of the Co-operative Banks.

The average interest rate on deposits in the commercial banks rose from 3.6 per cent in 1965 to 5.3 per cent in 1975. Longer-period and better-yielding deposits have gained in popularity. As long as indexed accounts were used, this did not raise the average rate of interest, for the banks paid a relatively low rate of interest on index-tied deposits and, on the other hand, index compensations paid when prices rose did not strain the banks' finances, because these index payments were collected from the borrowers. As the acceptance of indexed deposits was discontinued in connection with the stabilization measures in March 1968, funds from these accounts began to be transferred to high-interest deposit accounts. In 1968 the average rate of interest on deposits increased by more than half a percentage point. This development weakened the position of the banks and, as a result, the interest rate on deposits was reduced by ½—1 percentage point in all groups of banking institutions.

The average lending rate of interest was 7.4 per cent in 1965 and 9.8 per cent in 1975.

In 1975 the average interest rate on bills of exchange was 11.5 per cent, that on loans 9.5 per cent while overdrafts bore an average rate of about 10 per cent, normally 2 ½ per cent of which was commission.

The difference between the lending and deposit rates of the commercial banks was 3.8 per cent in 1965 and 4.5 per cent in 1975. The interest margin has been continuously rising during the last decades.

CO-OPERATION BETWEEN THE COMMERCIAL BANKS

The common interests of the Finnish commercial banks are supervised by the Finnish Bankers' Association founded in 1914. Its most important tasks are to maintain contacts with the State, other banking institutions and industrial organisations. This is primarily done by making statements and proposals. In addition, it deals with technical problems arising in banking and disseminates information to its members and to others.

The member banks are represented on the Board of Governors of the Finnish Bankers' Association, which is the decision-making body. Each member bank sends its general manager and his deputy to serve as members of the Association. The Finnish Bankers' Association represents the commercial banks in the Joint Delegation of the Banking Institutions, which discusses questions common to all the different groups of banking institutions.

THE FINNISH SAVINGS BANKS

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HISTORICAL BACKGROUND AND MAIN CHARACTERISTICS

Finland's first savings bank was founded in Turku in 1822. A second was soon established in the capital, Helsinki, in 1826. After this, it was the 1840s before other savings banks began to appear. They were the pioneers of Finnish banking because before their creation the only bank in the country was the Bank of Finland, which had been founded in 1811.

The years 1880—1920 were the most lively period in the history of the Finnish savings banks. At that time municipalities in particular played an important role in the establishment of savings banks. The total number of savings banks was at its highest in 1940 when there were 485. Since then, there has been a decline in their number, at first because of territorial concessions due to the war and then because of the amalgamation of the smaller banks. However, the decrease in the number of savings banks has not meant a decline in the number of offices. Since World War II the number of savings bank offices has increased rapidly as new branches have been founded.

The reasons for the establishment of savings banks were, in Finland as elsewhere, largely social. An effort was made to alleviate the poverty of the people by providing them with an opportunity and encouragement to save. At first the activities of the savings banks were very limited and they were run by volunteers. Only small deposits were accepted and the funds were invested in projects which involved the smallest possible risks.

As the economy expanded during the 19th century and the need for banking services became more diversified their activities began to expand beyond the original aims of the

founders. Deposits were accepted from all groups in society while housing, agriculture and studies were given a favoured position in their investment.

Today the Finnish savings banks are able to offer every type of banking service. However, certain fundamental characteristics have been maintained. The savings banks are still run by people elected by the depositors. They are local and independent and their purpose is to serve the common interest.

In law, a Finnish savings bank is similar to a non-profit foundation but it has, in addition, some special features that are stipulated in the Savings Bank Act of 1969. According to paragraph 1 of this Act, the savings bank is a monetary institution designed to provide normal banking services, but to not make profits for any individual. Its special objective is to promote saving.

A savings bank may be founded by a municipality or a number of municipalities or by a group of at least ten other Finnish organizations or by at least twenty respectable citizens with full civil rights. The principal administrative body is the Board of Trustees which must have at least twelve members. The precise number is laid down in the bylaws of the individual savings banks. The members of the Board of Trustees are representatives of the savers. Savings bank employees are not entitled to be trustees. The trustees are elected at a meeting of the existing trustees and those depositors entitled to vote. The legally-determined qualification for a voting right is a minimum deposit (e.g. 300 marks) in the savings bank in question. It is also required that the deposit should have been in the bank for a certain minimum time period (e.g. since the beginning of the calendar year preceding the election).

In some savings banks, a special meeting of depositors chooses a number of representatives to participate in the election of trustees.

The duties of the Board of Trustees correspond roughly to those of the supervisory body of a joint stock company and also partly to those of the shareholders' meeting. These include, inter alia, election of the Board of Management and auditors of the bank, decisions to open new branches and to sell real estate, confirmation of general instructions regarding the bank's activity, and confirmation of the closing of the books and the granting of freedom from responsibility to the Board of Management.

The Board of Management is responsible for the general management of the savings bank. There should be at least five members on the Board. The General Manager of the bank and other full time officials may be members of the Board but mostly the members are not employed by the bank. The trustees are not permitted to be members of the Board of Management.

Because the Board of Management cannot oversee the day to day practical management of the bank, it has normally delegated a part of its authority to the General Manager and one or more other full-time officials. This delegation of current business, applies in particular to granting credits within the limits authorised by the Board of Management.

STRUCTURAL FEATURES

At the end of 1975 there were 283 independent savings banks in Finland. They have a distinctly local or regional character and their activities are limited accordingly. An exception is the Finnish Workers' Savings Bank, which was established in 1971 by the amalgamation of five workers' savings banks from various parts of the country.

In the last ten years, amalgamation of savings banks has been very common. In the long run

the savings banks aim to form larger units by amalgamating savings banks situated within the same economically-coherent area.

Since every savings bank forms an independent unit, this kind of step can only be taken slowly. As local interests are safeguarded and satisfied, however, large regional savings banks are emerging. In the Northern and Eastern parts of the country the targets have been nearly attained. There are, at present, about 20 savings banks formed by mergers. In most cases, however, these banks do not cover the whole of their economic area.

	Dec. 31, 1965	Dec. 31, 1975
Number of savings banks	365	283
Number of offices	1 135	1 270
Number of employees	4 904	9 623

There were 1 270 savings bank offices at the end of 1975. Of these, 987 were branches and 283 were main offices. The number of offices is fairly large in comparison with total deposits. This can be explained by the fact that in the country there are many small branches that were opened in order to improve the service.

The savings banks employed 9 623 people at the end of 1975. In addition, 1 069 people were employed by the central organizations of the savings banks. Thus the total of people employed by the savings banks in Finland was 10 692.

THE NATURE AND EXPANSION OF SAVINGS BANK ACTIVITIES

As mentioned above, present-day savings banks are able to offer all the various banking services their customers might require. The Finnish savings banks have specialized in serving private individuals, housing and local industries. In co-operation with their central bank, they can even satisfy the needs of relatively large business enterprises. The analysis of the savings banks' activities below is based on the structure of their balance sheet.

SOURCES OF FUNDS

Table 1 reveals that the savings banks' funds originate almost exclusively from deposits made by the public. No funds are available from sources such as the foreign capital market and the Bank of Finland. However, the savings banks may draw indirectly from these sources for they may be granted credit by their central bank to invest in real estate or to support their liquidity position. Their central bank is entitled to raise funds from the Bank of Finland or abroad in the same way as the ordinary commercial banks are. »Liabilities to other domestic banks» in the balance sheet, which totalled 3.6 per cent of total liabilities in 1975, consists mostly of debts to the Central Bank of the Savings Banks (SKOP).

TABLE 1. BREAKDOWN OF THE SAVINGS BANKS' TOTAL LIABILITIES

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Deposits made by the public	3 103.9	90.0	10 412.5	88.0
Liabilities to the Bank of Finland	—	—	—	—
Liabilities to other domestic banks	50.7	1.5	434.5	3.6
Foreign liabilities	—	—	—	—
Domestic liabilities in foreign currency	—	—	—	—
Capital account	109.3	3.2	267.3	2.3
Other liabilities	183.5	5.3	717.9	6.1
Total	3 447.4	100.0	11 832.2	100.0

The residual »Other liabilities» is mostly composed of state funds transferred by the savings banks to customers on terms dictated by the Government.

The share of the savings banks' capital account in the balance sheet total has decreased from 3.2 per cent to 2.3 per cent over the ten-year period covered by the table. This development is partly attributable to the low profitability of banking institutions during that period. The decline in this share was not caused by losses but by the fact that reserves have been accumulated more slowly than the rate at which total liabilities have increased. However, the real solvency of the savings banks is consider-

ably greater than the figures suggest for real estate holdings are largely entered in the accounts at values considerably less than those realizable.

According to the 1969 legislation, the savings banks' capital accounts have to equal at least 2 per cent of their total liabilities, from which, however, certain reductions may first be made. The savings banks not fulfilling this requirement have been given a transition period of ten years, during which they must establish the required solvency ratio or merge with another savings bank.

Reaching the minimum solvency ratio and staying above it have proved to be very difficult for many savings banks. This is due to the fact that, in the framework of the present legislation, the savings banks can increase their capital account only by means of business surplus. As the liabilities of the banks have grown very quickly in the recent inflationary period, it has not been possible to accrue profits large enough to correspond to the growth of liabilities. This is one of the problems to be solved when the banking legislation will be revised in the near future. Appropriate methods should be found to increase the capital accounts of the savings banks from outside sources.

TABLE 2. DEPOSITS MADE BY THE PUBLIC, ACCORDING TO TYPE OF DEPOSIT

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Demand deposits (cheque accounts)	94.4	3.0	661.8	6.4
Time deposits (savings and deposit accounts)	2 066.6	66.6	6 933.5	66.6
Term deposits	942.9	30.4	2 817.2	27.0
Total	3 103.9	100.0	10 412.5	100.0

Table 2 shows the distribution of deposits made by the public between the various types of accounts in the savings banks. It is typical of the savings banks that the share of cheque accounts is relatively small. This reflects the predominance of private customers who in Finland are less likely than business customers to choose cheque accounts. In the last ten

years the share of cheque accounts has grown substantially. This is due to the activities of the savings banks in marketing their services to business enterprises.

Otherwise the breakdown of savings bank deposits is roughly similar to that in other banks. All Finnish banks pursue a common interest rate policy and thus their deposit rates and other conditions are the same. Since the type of customer varies between different banking institutions there are small differences in the distribution of deposits between the various types of account.

No accurate information is available on the customers of the savings banks or of the other Finnish banking institutions. However, it is evident that wage and salary earners are the most important savings bank depositors. In addition, people engaged in agriculture are significant to the savings banks, although less so than they are to the co-operative banks. Unlike the commercial banks, the share of the business sector is small. These features affect the accrual of deposits so that cyclical and seasonal variations in the growth of deposits at the savings banks differ from those at the commercial and co-operative banks.

ALLOCATION OF FUNDS

The investment of savings bank funds reflects clearly the nature of the Finnish financial market and the impact of legislation. Table 3 shows that loans to the public forms by far the largest item in savings bank assets. There has been only a slight change in the share of loans in total investment over the last ten years.

That part of savings bank funds which is not invested in loans is primarily cash or liquid reserves or real estate. The share of cash and liquid reserves was 10.8 per cent. This is in line with a provision of the Savings Bank Act according to which a savings bank must have a minimum cash reserve equalling 20 per cent of sight liabilities and 10 per cent of other

liabilities. The most important items included in the liquid reserve are cash, claims on domestic commercial banks and bonds accepted for this purpose. »Claims on other domestic banks» in the table consists mainly of deposits at the Central Bank of the Savings Banks.

TABLE 3. BREAKDOWN OF THE SAVINGS BANKS' TOTAL ASSETS

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Loans to the public	2 609.2	75.7	9 108.5	77.0
Shares and bonds	65.8	1.9	368.6	3.1
Cash	104.0	3.0	139.3	1.2
Foreign assets	—	—	—	—
Domestic assets in foreign currency	—	—	—	—
Claims on other domestic banks	346.8	10.0	1 080.3	9.1
Claims on the State	—	—	—	—
Real estate ¹	278.5	8.1	900.0	7.6
Other assets	43.1	1.3	235.5	2.0
Total	3 447.4	100.0	11 832.2	100.0

¹ Incl. an insignificant amount of movable property.

Bond and share portfolios do not play an important role in the savings banks. The Savings Bank Act limits the savings banks' holdings of shares. This does not, however, have any practical significance because the savings banks have not usually held shares other than those of their own central bank. Also the savings banks generally refrain from buying bonds other than those launched by the Finnish Real Estate Bank Ltd, which is owned by the Central Bank of the Savings Banks.

The share of real estate holdings is higher in the balance sheet of the savings banks than in other Finnish banking institutions. This is partly attributable to the large number of savings bank branches and partly to a tendency to invest in projects protected from inflation. According to the law, a savings bank may not, without special permission from the bank inspection authorities, invest more than 10 per cent of its total assets in real estate used as the bank's premises or used by its personnel. Other real estate holdings of a savings bank are also strictly limited.

DISTRIBUTION OF CREDIT BY SECTORS

Savings bank credit has traditionally been relatively long term and has been concentrated on housing, agriculture and personal loans for such purposes as the financing of studies. This is still the case, although there has been some diversification and the loan periods have become shorter. Table 4 illustrates the breakdown of credits by type of sector.

TABLE 4. CREDITS GRANTED TO THE PUBLIC, BY SECTOR

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Agriculture, forestry and fishing	546.8	20.9	1 372.4	15.1
Manufacturing, mining and quarrying	146.1	5.6	399.3	4.4
Electricity, gas and water	18.4	0.7	56.6	0.6
Construction and real estate	552.2	21.1	1 379.4	15.2
Trade, communications and other service industries	302.4	11.5	1 460.3	16.0
Municipalities and parishes	123.0	4.7	416.0	4.6
Personal and miscellaneous credits	927.4	35.5	4 015.5	44.1
Total	2 616.3	100.0	9 099.5	100.0

The most notable change in the table is the increase in the share of personal and miscellaneous credits, and a decline in credits granted to agriculture and construction and real estate. The greater part of this change is due to the tendency to finance housing by personal loans instead of loans granted to building companies. This development reflects an institutional feature of Finnish housing: typically even apartment houses are owned by the occupiers.

The table does not show the share of housing credits, which is 45 per cent of total credit granted by the savings banks. The major part of housing credit is included in personal and miscellaneous credits in the table.

The dominant position of long term loans is also reflected by the fact that the share of bill credits and cheque account overdrafts was

11.9 per cent of all credits in 1975. The most important form of credit is what are traditionally called long term loans. Some of these, however, are in fact fairly short term.

TABLE 5. CREDITS GRANTED TO THE PUBLIC, BY TYPE OF CREDIT

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Bills of exchange	156.8	6.0	933.3	10.2
Loans (granted against promissory notes)	2 398.7	91.9	8 020.5	88.1
Overdrafts (cheque accounts)	53.7	2.1	154.7	1.7
Total	2 609.2	100.0	9 108.5	100.0

OTHER SAVINGS BANK ACTIVITIES

The analysis based on the balance sheet does not illustrate all the diverse activities of the savings banks. The most important of those not yet discussed are bank guarantees and foreign exchange and payments transactions. In accordance with the Savings Bank Act the savings banks may grant bank guarantees up to 20 per cent of their lending. As regards foreign exchange and foreign payments, the savings banks act on the same basis as the branches of the commercial banks.

REVENUE AND EXPENDITURE OF FINNISH SAVINGS BANKS

The bulk of the savings banks revenue is from interest on lending. Other sources of income account for only about one fifth of total revenue. The figures in table 6 for 1965 and 1975 are not fully comparable due to changes in accounting practice. It is evident, however, that a remarkable increase in the share of »Other revenue» has taken place since 1965. This is due to the very rapid increase in the demand for banking services and the activities of the savings banks to increase their supply of services.

TABLE 6. DISTRIBUTION OF THE SAVINGS BANKS REVENUE AND EXPENDITURE

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Revenue				
Interest income and commission on lending	176.5	77.8	862.9	77.5
Interest income and commission on other investment	34.2	15.1	98.4	8.8
Profit on foreign exchange	—	—	—	—
Other revenue	16.1	7.1	152.2	13.7
Total	226.8	100.0	1 113.5	100.0
Expenditure				
Interest expenses	126.7	55.9	609.2	54.7
Salaries	41.0	18.1	232.0	20.8
Taxes	5.6	2.5	13.0	1.2
Depreciation	13.0	5.7	49.1	4.4
Other expenditure	31.3	13.8	208.3	18.7
Profit for the year	9.2	4.0	1.9	0.2
Total	226.8	100.0	1 113.5	100.0

As can be seen from table 6, the profitability of the saving banks was considerably lower in 1975 than in 1965. In the last years the decline on profitability has been stopped and the profits have been stabilized at their low level. The low profitability can mostly be attributed to the heavy increases in salaries and other costs necessitated by the improved service. The intensive utilization of computers has not yet resulted in a reduction in costs but, undoubtedly, the efficiency of the savings bank services has increased.

TABLE 7. AVERAGE LENDING AND DEPOSIT RATES OF INTEREST AND THE DIFFERENCE BETWEEN THEM

	Dec. 31, 1965		Dec. 31, 1975	
	Per cent			
Average lending rate of interest	7.53		10.47	
Average interest rate on deposits	4.18		5.98	
Interest margin	3.35		4.49	

The average rates of interest given in the table 7 reflect the general level of interest in each year and the gradual increase in the interest margin. Low profitability has compelled the savings banks to increase their lending rates and the excess demand for credit has made this possible. This has been the case in other banks as well. Consequently, the interest margin has

increased from 3.35 per cent in 1965 to 4.49 per cent in 1975.

The interest rate differentials applied by the savings banks are not very great. Their interest rate policy is determined more by the purpose of the loan than its guarantee and the length of the loan period.

The average rate of interest for bills of exchange was 12.7 per cent at the end of 1975. The corresponding rate for loans was 10.2 per cent. The figures given here are the averages for all savings banks. The rates may vary considerably between them.

CO-OPERATION BETWEEN FINNISH SAVINGS BANKS

It was mentioned above that the savings banks in Finland are independent. They have, however, organized a collaborative framework within which they function in many respects as if they were one banking institution with activities extending throughout the country. A savings bank depositor is entitled to make withdrawals and deposits at any savings bank in the country. Collaboration between the savings banks takes place through their central organizations. Of these, the Central Bank of the Savings Banks has already been mentioned. This keeps the liquid reserves of the savings banks, supports their lending activity and liquidity, acts as a central clearing house and takes care of foreign payments. In addition, it is responsible for the development of banking techniques in the savings banks, above all for the progress of automatic data processing. Other co-operative organizations are the Finnish Real Estate Bank Ltd, the Savings Banks' Pension Fund, Security Fund and Real Estate Agency and regional savings bank associations. A joint organization of all these associations and bodies and of all savings banks is the Finnish Savings Banks Association. Its responsibilities cover the general policy of the savings banks, their long-term planning and the marketing of savings bank services. It also disseminates and publishes information, provides for training and research and, in co-operation with the Bank Inspectorate, helps supervise the savings banks.

THE FINNISH CO-OPERATIVE BANKS

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HISTORICAL BACKGROUND AND MAIN FEATURES

There were several social factors that assisted the establishment of the co-operative banking organization in Finland. The political confusion at the end of the 19th century and the beginning of the 20th encouraged ideas of independence from Russian rule. However, it is unlikely that this dream of independence could have been realized without raising the standard of living of the poorest members of the community. Around the same time, Finland changed over from being a natural economy to being a monetary one. But small landowners in rural areas had little chance of getting loans, so it was hoped that the co-operative credit societies — as the co-operative banks were called up to 1970 — would be of special help in raising economic well-being. After studying the work of Friedrich Wilhelm Raiffeisen, founder of the co-operative credit society movement among Germany's farmers, Professor Hannes Gebhard started a co-operative banking system in Finland.

In Finland, the order of events was the reverse of that in most other countries which developed similar co-operative banking systems. First, in 1902, the Central Bank of the Co-operative Banks of Finland Ltd (OKO) was founded. Then, in the same year, the first of the co-operative banks opened. A lack of capital at the start restricted operations to a fairly modest scale. Co-operative banking changed slightly after independence, but in 1920 the operations expanded considerably as co-operative banks were authorised to accept deposits from people who were not members.

The activities of the co-operative banks are regulated by the Co-operative Society Act and

a special Co-operative Bank Act. They are financial institutions owned by their members. Final authority is vested in the Co-operative Society Meeting, at which the members decide on matters such as the granting of freedom of responsibility for the accounts. In some co-operative banks which have a wide sphere of operation, the members' power of decision is wielded by a Board of Representatives elected by and from the members. The Co-operative Society Meeting or the Board of Representatives elects the Board of Administration. The Board of Administration supervises the administration and has certain decision-making powers, which are laid down in greater detail in the regulations of each bank. The Board of Administration elects a Board of Directors with a Managing Director and from 4 to 8 members to represent and manage the bank. The Board of Directors may delegate its power to the staff of a branch office in matters concerning the internal operations of that branch, e.g. the granting of loans.

THE CO-OPERATIVE BANK ORGANIZATION

In addition to OKO, which acts as the central financial institution of the co-operative banks, there were 489 independent co-operative banks in operation at the end of 1965. By 1975 their number had fallen to 384. The number of branches fell, in the same period, from 1 221 to 1 195. The fall in the number of independent co-operative banks is the result of amalgamation, but the bank network still covers the whole country. The co-operative banks employed 7 496 people at the end of 1975 and of these 6 106 were women. In addition, 996 people were employed by the central organizations of the co-operative banks, so the total of people employed by the co-operative banks was 8 492.

THE NATURE AND EXTENT OF CO-OPERATIVE BANKING

The co-operative banks provide a full banking service, and although the main emphasis has been on agriculture and related industries, substantial funds have also been granted to other sectors and the banking services they require have been provided. Private individuals feature conspicuously in the co-operative banks' credit granting.

The Finnish financial institutions acquire the bulk of their funds in the form of deposits by the public. In 1965 the co-operative banks and their central bank, OKO, took 19.7 per cent of total deposits by the public. In 1975 the corresponding figure was 20.4 per cent. Measured in terms of deposits, therefore, the co-operative banking organization accounts for about a fifth of all banking activities in Finland.

SOURCES OF FUNDS

TABLE 1. BREAKDOWN OF THE CO-OPERATIVE BANKS' TOTAL LIABILITIES

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Deposits made by the public	2 009.8	77.0	8 053.2	80.4
Liabilities to the Bank of Finland	—	—	—	—
Liabilities to other domestic banks (liabilities to OKO and loans from others)	529.9	20.3	1 448.3	14.5
Foreign liabilities	—	—	—	—
Domestic liabilities in foreign currency	—	—	—	—
Capital accounts (co-operative capital, reserve and other funds and profits)	36.2	1.4	286.5	2.9
Other liabilities (transferred items and other liabilities)	33.8	1.3	225.9	2.2
Total	2 609.7	100.0	10 013.8	100.0

The co-operative banks' balance sheets do not show liabilities to the Bank of Finland, as OKO is the only one to have a debit-credit relationship with the Bank of Finland. OKO acts as the

balancing factor in the co-operative banks' liquidity requirements and, if necessary, applies to the Bank of Finland. The »liabilities to other domestic banks» in Table 1 almost entirely consists of the co-operative banks' debt to OKO. A large proportion of this debt comprises State loans made through the co-operative banks. As all operations connected with foreign business pass through OKO, co-operative banks do not show any foreign liability or asset items.

TABLE 2. DEPOSITS MADE BY THE PUBLIC, ACCORDING TO TYPE OF DEPOSIT

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Demand deposits (cheque accounts)	76.9	3.8	534.5	6.6
Time deposits (savings and deposit accounts)	1 412.9	70.3	5 519.4	68.4
Term deposits	520.0	25.9	2 018.1	25.0
Total	2 009.8	100.0	8 072.0	100.0

The proportion of cheque accounts has risen in the co-operative banks during the period examined.

ALLOCATION OF FUNDS

In the ten-year period under review, the balance sheet total of the co-operative banks rose 3.8 fold. When studying the allocation of funds, it must be noted that OKO plays an important role in fund investment by the co-operative banks.

TABLE 3. BREAKDOWN OF THE CO-OPERATIVE BANKS' TOTAL ASSETS

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Loans to the public	2 030.6	78.1	7 797.5	77.9
Shares and bonds	149.3	5.7	447.8	4.5
Cash	34.5	1.3	102.6	1.0
Foreign assets	—	—	—	—
Domestic assets in foreign currency	—	—	—	—
Investments in OKO and deposits with other banks	225.1	8.7	1 157.6	11.5
Claims on the State	—	—	—	—
Real estate	127.1	4.9	306.7	3.1
Transferred items, movable assets, other funds, losses	43.1	1.3	201.6	2.0
Total	2 609.7	100.0	10 013.8	100.0

Loans to the public account for the bulk of co-operative bank funds allocated. In 1965 such loans accounted for 47.8 per cent; this figure included loans granted from State funds.

Shares and bonds accounted for a lower proportion of the co-operative banks' balance sheet total in 1975 than a decade before. These forms of investment play only a minor role in Finnish banking because of the undeveloped character of the financial market.

The new legislation on co-operative banks, which came into force at the beginning of 1970, laid down that the co-operative banks must maintain a cash reserve equal to 20 per cent of their sight liabilities plus 10 per cent of their other liabilities so as to ensure liquidity. This cash reserve is mostly deposited with OKO. Deposits by the co-operative banks in OKO have risen during the period under review, but the cash figure has continued to be rather low.

DISTRIBUTION OF CREDIT BY SECTORS

In both 1965 and 1975, a considerable proportion of the co-operative banks' credit went to finance agriculture, forestry and fishing but,

TABLE 4. CREDITS GRANTED TO THE PUBLIC, BY SECTOR¹

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Agriculture, forestry and fishing	872.2	37.1	2 495.7	28.4
Manufacturing, mining and quarrying	385.3	16.4	814.4	9.3
Electricity, gas and water	34.3	1.5	56.9	0.6
Construction and real estate	203.3	8.7	861.9	9.8
Trade, communications and other service industries	288.6	12.2	1 333.8	15.1
Municipalities and parishes	77.8	3.3	480.1	5.5
Personal and miscellaneous credits	490.6	20.8	2 762.0	31.3
Total	2 352.1	100.0	8 804.8	100.0

¹ Incl. OKO.

as the industrial structure has changed, so the proportion going to these industries has fallen. Meanwhile, because a considerable proportion of personal and miscellaneous loans are used for real estate or shares in housing companies, the amount of credit granted for housing has risen appreciably. The service industries, at 15.1 per cent, were the third main group receiving credit from the co-operative banks.

When examining the distribution of credit-granting, it should be noted that the above table also includes credits granted from State funds. The bulk of these credits goes to agriculture.

TABLE 5. CREDITS GRANTED TO THE PUBLIC, BY TYPE OF CREDIT

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Bills of exchange	192.3	9.5	875.7	11.2
Loans (granted against promissory notes)	1 796.1	88.4	6 765.8	86.8
Overdrafts (cheque accounts)	42.2	2.1	156.7	2.0
Total	2 030.6	100.0	7 798.2	100.0

The percentage of bills of exchange has grown at the expense of loans. These figures can be misleading, however, since formally short-term loans are often quite long-term, as they are frequently renewed. As the table shows, co-operative bank credit is relatively long-term.

REVENUE AND EXPENDITURE OF FINNISH CO-OPERATIVE BANKS

The bulk of revenue is from interest and commission. However, the proportion of interest revenue fell quite a lot during the period, while. »Other revenue», which consists mainly of charges made for various services, rose. In spite of the rise in service revenue, interest revenue from credit-granting is still by far the most important source of co-operative bank income. On the expenditure side, interest expenses and salaries are the largest items. This is natural enough considering that the main emphasis in co-operative bank operations is on

**TABLE 6. DISTRIBUTION OF
THE CO-OPERATIVE BANKS'
REVENUE AND EXPENDITURE**

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Revenue				
Interest income and commission on lending	133.3	81.1	705.3	77.4
Interest income and commission on other investment	22.5	13.6	101.1	11.1
Profit on foreign exchange	0.1	0.0	1.5	0.2
Other revenue	8.5	5.3	103.2	11.3
Total	164.4	100.0	911.1	100.0
Expenditure				
Interest expenses	94.0	57.2	492.2	54.0
Salaries	30.8	18.7	193.1	21.2
Taxes	2.4	1.4	13.4	1.5
Depreciation	8.0	4.9	21.1	2.3
Other expenditure	26.7	16.3	186.2	20.4
Profit for the year	2.5	1.5	5.1	0.6
Total	164.4	100.0	911.1	100.0

the acquisition of deposits and the investment of these funds. However, the number of other functions has grown, as is reflected by the change in the distribution of revenue.

TABLE 7. AVERAGE LENDING AND DEPOSIT RATES OF INTEREST AND THE DIFFERENCE BETWEEN THEM

	Dec. 31, 1965		Dec. 31, 1975	
	Per cent			
Average lending rate of interest	7.75		10.52	
Average interest rate on deposits	4.04		5.93	
Interest margin	3.41		4.59	

The average lending rate of interest has been calculated from promissory-note loans, bills of exchange and utilized overdrafts. The average interest rate on deposits is the weighted average interest paid on deposits by the public. Both interest rates have been calculated using the end-of-year figures.

CO-OPERATION BETWEEN FINNISH CO-OPERATIVE BANKS

OKO is a commercial bank as defined in the Co-operative Bank Act, operating as the central

bank of the co-operative banks. In consequence of its status as a central bank, certain relationships between the co-operative banks and OKO have been given a special legal status. For instance, the liabilities of the co-operative banks to OKO are not taken into account when calculating the co-operative banks' cash reserve requirement and the countersecurities given by the co-operative banks to OKO are not included when defining the upper limit on the co-operative banks' right to give guarantees.

OKO has been vested with the following duties:

It acts as an accumulator and investor of the co-operative banks' funds and cash reserves, and thus ensures the liquidity of the whole system. OKO also handles financial relations with the Bank of Finland.

It controls the organization's internal payments clearing system and represents the organisation in clearing between the various banking groups.

It acts as agent for the organization's foreign financing and payment transactions.

OKO also has several other functions aimed at developing the organization, increasing revenues, minimizing costs and spreading costs equally within the organization. These functions include handling the organization's purchasing of materials, supplying ADP services, providing legal and other advice, and participating in the financing of the costs of OKL (Central Union of the Co-operative Banks of Finland).

OKL is the ideological central organization of the co-operative banks, the purpose of which is to promote co-operative banking. All Finnish co-operative banks and OKO are members of OKL. OKL's duties include the inspection of co-operative banks, arranging for research connected with their operational planning, consultation, training and generally promoting the banks' interests. OKL also carries out investigations of customers' credit-rating and supplies credit information to the co-operative banks. Furthermore, its duties include joint advertising,

co-operative bank publications and compilation of statistics. OKL also supervises and directs the activities of the provincial co-operative banks' leagues.

CO-OPERATIVE BANK INSPECTION

There are stipulations about co-operative bank inspection in the Co-operative Bank Act that came into force on January 1, 1970 and in the

statute of July 15, 1970 on co-operative bank inspection.

Under the present regulations, the central organization of the co-operative banks, i.e. the Central Union of the Co-operative Banks, is responsible for arranging proper inspection of the co-operative banks' activities. The work of this inspection body is directed and supervised by the Bank Inspectorate.

POSTIPANKKI IN FINLAND

by Matti Korhonen, M. Sc. (Econ.)

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HISTORICAL BACKGROUND AND MAIN CHARACTERISTICS

Postipankki, (formerly the Post Office Savings Bank)², was founded in 1886, following the example of several other European countries. The aim was to expand the opportunities for the public to make deposits by authorizing the post offices to accept deposits. The branch network of Finnish banks was still quite underdeveloped at that time. However, Postipankki did not exert any significant influence on the Finnish financial market until the 1940s. Before that decade its share in total bank deposits made by the public was only 2—3 per cent. In comparison with other banks, Postipankki's operating conditions were not good; for instance, the interest rate paid on its deposits was usually lower than that applied by the other banking institutions. Legislation also put limits on the Bank's activities. However, in periods characterized by uncertain economic conditions the share of Postipankki in total deposits tended to rise, because the Treasury was responsible for its obligations.

Postipankki began to develop strongly after postal giro was inaugurated during the war. The large-scale deposits and withdrawals by the Treasury in the exceptional war-time circumstances sharply increased the postal giro service. At the beginning of the 1940s, it became possible to make withdrawals from all post offices in the country without giving notice. This gave depositors a marked advantage in the unusual conditions then prevailing. The final breakthrough for Postipankki came after the war when the Treasury used Postipankki's savings books to pay the »repatriation

payments» to soldiers returning from the war and to compensate those people moving from the areas lost in the war. Since the return of normal conditions, the Treasury has exerted no influence on the deposit activity of Postipankki, and it has been compelled to compete with the other banks for deposit. At present, Postipankki is the third largest bank in the country, and its share in total deposits accepted from the public is approximately 14 per cent.

Postipankki is a state business enterprise. Its administration is separate from that of the Postal Services, although the major part of the bank's cash transactions are effected through the post office network. Postipankki is subordinate to the Ministry of Finance and the Postal and Telecommunication Services to the Ministry of Transport and Communications.¹ Postipankki compensates the Post Office for its services on the basis of the unit cost principle as well as for the postal charges incurred.

Postipankki is under the control of the Ministry of Finance. The highest decision-making body is the Supervisory Board appointed every three years by the Cabinet. The central bank (the Bank of Finland), the General Directory of Posts and Telegraphs, the Ministry of Finance and the Treasury must all have a representative on the Supervisory Board. It gives general instructions regarding the management of the bank and its development. It also confirms the Auditors' Report and decides upon the credit policy to be pursued by the bank.

The practical policy of Postipankki is decided by the Board of Management, which consists of the Director-General and a Deputy Director-

¹ Revised by Mr. Viljo Koponen.

² »Postipankki» is the bank's registered name in every language except Swedish where it is »Postbanken».

¹ Postipankki is more independent of the Post Office than are corresponding institutions in most European countries. However, a fairly similar situation exists in Austria.

General, who are appointed by the President of the Republic, and of three Directors elected by the Supervisory Board.

The revised regulations governing Postipankki came into force in 1970. These were introduced as part of the comprehensive reform of Finnish banking legislation. The new act laid down that Postipankki should operate under the same terms as other banking institutions in Finland. The new regulations provided Postipankki with the right to grant business credits (postal giro overdrafts and bills of exchange) and bank guarantees and to expand its foreign activities. At the same time, the bank's name »Postisäästöpankki» (Post Office Savings Bank) was changed to »Postipankki».

The Investment Fund of Finland, whose loans are granted through Postipankki at the bank's risk, was founded in 1975. The Supervisory Board of Postipankki grants the loans, and the Board of Management of Postipankki, enlarged by five additional members, deals with matters related to these loans; the five additional members represent certain ministries and the industrial sector.

STRUCTURAL FEATURES

The post office bank activity in Finland is pursued exclusively by Postipankki. At the end of 1977, it had, in addition to its Head Office, 24 branch offices and two mobile branches. Most of the bank's cash transactions are carried out through post offices, which totalled 3 093 at the end of 1975. In addition, the thirteen offices of the Bank of Finland provided services rendered by Postipankki. At the end of 1965, the total number of places where post office bank services were available was 2 578 and at the end of 1975 3 132, nearly half of the total number of offices of ordinary banking institutions.

Apart from the personnel of Postipankki, there are more than 10 000 persons engaged in the provision of post office bank services. At the end of 1965, Postipankki's personnel totalled

2 102 and at the end of 1975 5 441, of whom approximately 85 per cent were women.

THE NATURE AND EXPANSION OF POSTIPANKKI'S ACTIVITIES

On the basis of its new regulations, Postipankki has been expanding its activities, so that they are now quite similar to those of the commercial banks. It accepts deposits from the public on the same terms as other banking institutions. The rates of interest to be applied are decided by the Joint Delegation of the Banking Institutions. Payment transfers are effected through the postal giro service, which competes with the private banks' giro system but also co-operates with it in some ways. The number of transfers made by Postipankki was 137 million in 1975. The postal giro services have been decentralized into seven computerized recording centres around the country.

The bulk of the Treasury's deposits and withdrawals are effected through Postipankki. The Treasury's payments account for about one fifth of Postipankki's total transactions.

SOURCES OF FUNDS

Table 1 shows that Postipankki's funds consist primarily of deposits made by the public. The breakdown of liabilities is shown in Table 1 and that of deposits in Table 2. It is characteristic of Postipankki that the share of demand deposits, even excluding the Treasury's and banks' receivables, in its total deposits is greater than in any other group of banking institutions. This can be ascribed to the bank's postal giro service, which is used by almost all business enterprises in Finland.

Most of the deposits with Postipankki are ordinary time deposits, while the share of term deposits in total deposits is smaller than in other banks. At the end of 1975, deposit accounts with cheque and postal giro facilities accounted for seven per cent of total ordinary deposits made by the public in Postipankki.

**TABLE 1. BREAKDOWN OF POSTIPANKKI'S
TOTAL LIABILITIES**

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Deposits by the public	1 082.6	76.7	5 470.9	73.7
Giro account claims of the Treasury	183.7	13.0	452.6	6.1
Liabilities to the Bank of Finland	—	—	—	—
Liabilities to other domestic banks	39.2	2.8	408.2	5.5
Foreign liabilities	—	—	197.8	2.7
Domestic liabilities in foreign currency	—	—	38.9	0.5
Capital accounts	42.6	3.0	230.8	3.1
Other liabilities	62.8	4.5	623.9	8.4
Total	1 410.9	100.0	7 423.1	100.0

**TABLE 2. DEPOSITS MADE BY THE PUBLIC,
ACCORDING TO TYPE OF DEPOSIT**

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Demand deposits (postal giro accounts)	309.4	28.6	2 300.7	42.1
Time deposits (savings and deposits accounts)	678.1	62.6	2 706.1	49.4
Term deposits	95.1	8.8	464.1	8.5
Total	1 082.6	100.0	5 470.9	100.0

The balance on the average time deposit account is relatively small, which suggests that small-scale savers form a large group among the customers of Postipankki. There are more than three million account holders.

ALLOCATION OF FUNDS

As shown in Table 3, most of Postipankki's funds are invested in loans granted to the private sector. However, in 1965 more than 40 per cent of Postipankki's funds were still lent to the Central Government, mainly in the form of bonds. In the early 1970s the Central Government's borrowing requirement declined, owing to its improved financial position. The Central Government invested substantial amounts of its liquid assets in Postipankki, and these were further placed with various banking institutions, mainly the Bank of Finland. Instead of government bonds, Postipankki has in recent years acquired private bonds. The balance sheet items »Foreign assets» and »Domestic

assets in foreign currency» shown in Table 3 and the corresponding liability items in Table 1 were introduced in the 1970s.

At the end of 1975, advances granted by Postipankki, including bonds but excluding loans granted by the Investment Fund of Finland, totalled 6 305.6 million marks. Of this, loans to the private sector accounted for 5 888 million marks. The distribution of credit is shown in Table 4.

By the end of 1976, the Investment Fund of Finland had granted 931 million marks in loans through Postipankki; the majority of these loans was denominated in foreign currencies.

**TABLE 3. BREAKDOWN OF POSTIPANKKI'S
TOTAL ASSETS**

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Loans to the public	702.3	49.8	5 487.8	73.9
Shares and bonds	334.5	23.7	415.7	5.6
Cash	12.6	0.9	72.9	1.0
Foreign assets	—	—	391.9	5.3
Domestic assets in foreign currency	—	—	155.2	2.1
Claims on other domestic banks	51.4	3.6	202.0	2.7
Claims on the State	247.3	17.5	290.7	3.9
Real estate	10.6	0.8	82.6	1.1
Other assets	52.1	3.7	324.3	4.4
Total	1 410.8	100.0	7 423.1	100.0

**TABLE 4. CREDITS GRANTED TO THE PUBLIC,
BY SECTOR**

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Agriculture, forestry and fishing	0.3	0.1	33.8	0.6
Manufacturing, mining and quarrying	130.5	18.2	1 856.0	31.5
Electricity, gas and water	127.4	17.8	591.2	10.0
Construction and real estate	270.3	37.7	1 063.9	18.1
Trade, communications and other service industries	32.2	4.5	602.0	10.2
Municipalities and parishes	58.2	8.1	648.4	11.0
Personal and miscellaneous credits	97.7	13.6	1 092.7	18.6
Total	716.6	100.0	5 888.0	100.0

The Central Government apart, the construction and real estate sector was still in the 1960s the most important recipient of Postipankki's credits. In the recent years, the shares of industry and services in total credits granted by the bank have increased substantially. Municipalities and parishes have also received considerable advances. The loans granted to private persons have largely been intended for the acquisition of dwellings, but in recent years, Postipankki has also become a significant supplier of study loans. The share of electricity, gas and water has dropped markedly from the level of the 1950s, when extensive investment in electrification was carried out in Finland. However, almost two thirds of all bank loans granted to this sector are still supplied by Postipankki. The regulations for Postipankki which were in force up to the end of 1969 set limits on the granting of short-term credit by the bank. Since the new regulations came into force in 1970, Postipankki has increasingly granted bill and postal giro credits, as well as credits denominated in foreign currency, particularly to its business customers.

TABLE 5. CREDITS GRANTED TO THE PUBLIC, BY TYPE OF CREDIT

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Bills of exchange	10.1	1.4	255.7	4.7
Loans (granted against promissory notes)	697.3	98.6	5 109.3	93.1
Overdrafts (postal giro accounts)	—	—	122.8	2.2
Total	707.4	100.0	5 487.8	100.0

THE STRUCTURE OF REVENUE AND EXPENDITURE

The largest source of revenue is investment income (see Table 6). Investment includes both lending and investment in securities. Other revenue originates mainly from service charges, even though profit on foreign exchange has started to play a more important role.

On the expenditure side, interest expenses make up the largest item. However, the relative share of this item is smaller than in other banking institutions, which can be ascribed to the high proportion of demand deposits in total deposits with Postipankki.

TABLE 6. DISTRIBUTION OF POSTIPANKKI'S REVENUE AND EXPENDITURE

	1965		1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Revenue				
Interest on lending	84.9	90.0	673.7	89.0
Interest income on other investment				
Profit on foreign exchange	—	—	13.8	1.8
Other revenue	9.5	10.0	69.6	9.2
Total	94.4	100.0	757.1	100.0
Expenditure				
Interest expenses	37.1	39.2	328.7	43.5
Salaries	20.1	21.2	163.6	21.6
Taxes	0.8	0.8	3.2	0.4
Depreciation	2.9	3.1	42.5	5.6
Other expenditure	25.2	26.9	203.0	26.8
Profit for the year	8.3	8.8	16.1	2.1
Total	94.4	100.0	757.1	100.0

The second largest item is salary expenditure. Other expenditure includes the compensation paid to the Post Office for its services; in 1975 this accounted for 13.7 per cent of total expenditure. As in other Finnish banks, Postipankki's annual profits have increased less rapidly than its total assets. Half of the profit has generally been transferred to the Central Government. During the years under review, the share of taxes in total expenditure was very small, but it rose, due to a revision in taxation bases in 1976, to almost tenfold.

As a result of a rise in the general level of interest rates in 1973, the average lending rate applied by Postipankki also rose, although, along with the commercial banks' rates, it remained clearly lower than that applied by the savings and co-operative banks. In particular, the rates of interest on housing loans were relatively low. The slower rise in the average

interest rate on deposits was mainly due to the fact that the share of demand deposits, on which interest rate is low, rose from 28.6 per cent to 42.1 per cent.

TABLE 7. AVERAGE LENDING AND DEPOSIT RATES OF INTEREST AND THE DIFFERENCE BETWEEN THEM

	Dec. 31, 1965	Dec. 31, 1975
	Per cent	
Average lending rate of interest	7.14	9.88
Average interest rate on deposits	3.15	4.17
Interest margin	3.99	5.71

CO-OPERATION BETWEEN POSTIPANKKI AND OTHER BANKING INSTITUTIONS AND THE SUPERVISION OF THE BANK

Postipankki is a member of the Joint Delegation of the Banking Institutions, which deals with questions that are of relevance for all the groups of banking institutions and which, in practice, determines the interest rates on deposits and bank tariffs. As for the latter, however, Postipankki follows the terms of the international postal agreement and deviates, to some extent, from the tariff agreements of the other banks. Other banking institutions are supervised by the Bank Inspectorate, but the Ministry of Finance is directly responsible for the supervision of Postipankki.

THE FINNISH INSURANCE COMPANIES

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HISTORICAL BACKGROUND AND MAIN FEATURES

Insurance activity in its modern sense began in Finland in the 19th century. The first fire insurance office was opened in 1816, and the year 1832 saw the foundation of a nation-wide fire protection society. The first life assurance company was started in 1874. At the beginning of 1977, there were 57 insurance companies in Finland. There were, in addition, 272 relief funds, 73 unemployment funds and 380 pension foundations, which carry out social personal insurance, and 250 non-life insurance associations. Apart from the domestic insurance institutions, two foreign insurance companies have subsidiaries in Finland. The national pension and sickness insurance schemes are operated by the state-owned Social Insurance Institution. Pension insurance for persons employed by private firms and the self-employed is mainly underwritten by private insurance companies. The Central Pension Security Institute supervises these companies and carries out other tasks relating to statutory pension insurance.

Mutual and joint-stock insurance companies are governed by the Insurance Companies Act passed in 1952. The latter are regulated by the Joint Stock Company Act (1895) as well. In addition, there are stipulations concerning insurance activity in the Insurance Contracts Act (1933), the Employment Accidents Insurance Act (1948), the Motor Insurance Act (1959) and the various laws on employment pensions passed in the 1960s. A law concerning the right of foreign insurance companies to carry out insurance business in Finland was passed in 1933.

A government licence is required for carrying out insurance business in Finland. The financial and other requirements which must be met before a licence is granted vary and depend on which type of insurance is being underwritten. Only a Finnish insurance company may issue motor insurance, employment accident insurance or pension insurance.

In a mutual or joint-stock insurance company, final authority is exercised by policy-holders or shareholders in the meeting at which the Board of Management is elected, unless this task is delegated to the Supervisory Board which is always elected at the annual meeting. The members of the Supervisory Board and the Board of Management must be Finnish citizens living permanently in this country. The Board of Management represents the insurance company and takes care of all the tasks which do not devolve on the company's other organs on the basis of the company's articles of association. The members of the Supervisory Board and the Board of Management are, naturally, responsible for the measures they take on behalf of the company.

STRUCTURE OF THE FINNISH INSURANCE COMPANY SYSTEM

As mentioned above, 57 insurance companies were operating in Finland at the beginning of 1977. Ten years ago there were 64 Finnish insurance companies. This decline is due to mergers, which have come about in the past few years as the financial climate has become less favourable for insurance companies. Some companies have made collaborative agreements without merging in order to improve their

ability to meet obligations. It is obvious that the rise of the cost level and the increase in the amount paid in compensation will create pressure for still closer co-operation and possibly more mergers.

The law allows a life insurance company to carry out only personal insurance business (e.g. voluntary life and pension insurance), and its reinsurance. Hence companies have formed groups which co-operate in the underwriting of all types of insurance. At the moment there are five such groupings.

The field organization of the insurance companies includes the office and agency network as well as part-time agents. There are more than 400 insurance company offices and agencies. The employment pension scheme has recently begun to make use of the branch network of the commercial banks. The settlement of claims requires the services of special inspectors and other personnel, and in all there are 9 000 full-time employees in insurance.

SOURCES OF FUNDS

The major part, almost 90 per cent, of the insurance companies' liabilities consists of risk liabilities arising from claims or potential claims by policy-holders. These are presented in the insurance reserve, which is divided between the premium reserve and the outstanding claims reserve. See Table 1.

The share of the insurance reserve has remained more or less unchanged during the period under review, whereas the insurance reserve in itself has changed considerably. The share of the premium reserve in total liabilities has decreased from 61.9 per cent to 46.1 per cent, while the share of the outstanding claims reserve has increased from 26.2 per cent to 42.8 per cent. This trend is mainly due to the fact that the funds reserved for commenced pension payments are entered under the outstanding claims reserve, and the number of pensioned-off people has increased annually on the basis of the statutory pension insurance which took effect in 1962.

Other external capital (external funds) accounts for about 5 per cent of the total liabilities of the insurance companies, and fluctuations in this share have been insignificant.

The share of capital accounts has declined from 5.0 per cent in 1965 to 2.7 per cent in 1975. The insurance companies' capital accounts have more than doubled in absolute terms during the period under review. The decline in the relative share can be partly explained by the taxation system; the heavy taxation of funds raised internally makes this form of finance expensive as compared with external financing. The relative decline of the capital accounts cannot go beyond certain limits because there are legal stipulations on a minimum share.

TABLE 1. BREAKDOWN OF INSURANCE COMPANIES' TOTAL LIABILITIES

	Dec. 31, 1965			Per cent	Dec. 31, 1975			Per cent
	Pension and life insurance	Non-life insurance	Total		Pension and life insurance	Non-life insurance	Total	
	Mill. mk				Mill. mk			
Liabilities								
External funds	48.9	133.6	182.5	6.1	223.8	527.5	751.3	5.3
Insurance reserve								
Premium reserve	1 516.1	338.7	1 854.8	61.9	5 621.4	914.9	6 536.3	46.1
Outstanding claims reserve	32.9	752.5	785.4	26.2	2 700.5	3 370.1	6 070.6	42.8
Capital accounts	38.8	109.8	148.6	5.0	83.8	303.5	387.3	2.7
Other liabilities	4.1	19.4	23.5	0.8	193.1	247.3	440.4	3.1
Total	1 640.8	1 354.0	2 994.8	100.0	8 822.6	5 363.3	14 185.9	100.0

TABLE 2. BREAKDOWN OF INSURANCE COMPANIES' TOTAL ASSETS

	Dec. 31, 1965				Dec. 31, 1975			
	Pension and life insurance	Non-life insurance	Total	Per cent	Pension and life insurance	Non-life insurance	Total	Per cent
	Mill. mk							
Assets								
Liquid assets								
Cash, bank and postal giro accounts	14.0	91.4	105.4	3.5	54.6	92.3	146.9	1.0
Other claims	14.9	147.8	162.7	5.4	179.4	311.7	491.1	3.5
Other insurance companies share in risk liabilities	33.0	148.7	181.7	6.1	64.5	400.8	465.3	3.3
Investments	1 470.8	857.2	2 328.0	77.7	7 680.2	3 230.2	10 910.4	76.9
Fixed assets	46.9	89.9	136.8	4.6	187.6	422.5	610.1	4.3
Other assets	61.2	19.0	80.2	2.7	656.3	905.8	1 562.1	11.0
Total	1 640.8	1 354.0	2 994.8	100.0	8 822.6	5 363.3	14 185.9	100.0

ALLOCATION OF FUNDS

On the assets side of the insurance companies' balance sheet, investments form the largest item and account for slightly less than 80 per cent of the total assets. See Table 2.

The share of investments is higher in life (including pension) insurance companies than in other insurance companies.

The liquid assets of non-life insurance companies are both relatively and absolutely much larger than those of life and pension insurance companies. This difference can be partly attributed to the fact that the estimation of potential claims is more difficult for non-life insurance companies, and they therefore have a greater need for liquidity. In addition, the average size of non-life insurance companies calculated on the basis of the insurance reserve is smaller than that of life and pension insurance companies.

Table 2 further indicates that the other insurance companies' share of the risk liabilities has decreased from 6 per cent in 1965 to 3 per cent in 1975. The decrease is largely a result of the fact that the major part of the growth of the insurance business stems from pension and other personal insurance which is generally almost entirely retained on own account. The changes indicated by the other items are mainly due to the changes in the accounting principles introduced in 1974.

Loans and bonds form more than 80 per cent of the insurance companies' investments. As regards the allocation of credit, there are two significant changes; the share of industry has increased from 33 per cent in 1965 to 39 per cent in 1975. The share of trade and communications has also increased to some extent. The insurance companies are, at present, mainly financing the corporate sector and house-building; the share of private individuals has consequently dropped. The increase of the credit granted to industry is partly explained by the fact that the early 1970s was a period of heavy industrial expansion in Finland. The share of the public sector has decreased somewhat primarily because of a relative decrease of the financing needs of the Government and the municipalities. See Tables 3 and 4.

The share of lending in total investment decreased slightly in spite of the considerable use of borrowing options by policy-holders of life and pension insurance companies. These loans amounted to 3 652 million marks and accounted for 41 per cent of the total lending of these insurance companies in 1965. In place of lending, insurance companies increased their investment in real estate owing to an attempt to concentrate on assets whose value was stable at a time characterized by rapid inflation.

In 1975, as much as 40 per cent of lending, excluding lending to policy-holders, was guaranteed on real estate mortgage. Bank guarantees

TABLE 3. BREAKDOWN OF INSURANCE COMPANIES' LOANS BY GROUPS OF RECIPIENTS INCL. BONDS AND ADVANCES TO POLICY-HOLDERS (RE-LENDING)

	Dec. 31, 1965				Dec. 31, 1975			
	Pension and life insurance	Non-life insurance	Total	Per cent	Pension and life insurance	Non-life insurance	Total	Per cent
	Mill. mk							
Construction and real estate	224.3	199.1	423.4	20.8	1 082.6	729.8	1 812.4	20.3
Industry	507.9	162.8	670.7	33.1	2 891.3	603.1	3 494.4	39.1
Electricity, gas and water	42.9	16.3	59.2	2.9	198.0	62.2	260.2	2.9
Trade and communications	256.5	128.7	385.2	18.9	1 347.1	497.6	1 844.7	20.7
Central and local government	165.5	109.2	274.7	13.5	713.1	321.3	1 034.4	11.6
Other credits	116.2	104.0	220.2	10.8	316.8	162.8	479.6	5.4
Total	1 313.3	720.1	2 033.4	100.0	6 548.9	2 376.8	8 925.7	100.0

TABLE 4. BREAKDOWN OF INSURANCE COMPANIES' INVESTMENTS

Investments	Dec. 31, 1965				Dec. 31, 1975			
	Pension and life insurance	Non-life insurance	Total	Per cent	Pension and life insurance	Non-life insurance	Total	Per cent
	Mill. mk							
Loans	1 200.7	652.9	1 853.6	79.7	6 097.2	2 224.4	8 321.6	76.3
Bonds	112.8	67.2	180.0	7.7	451.7	152.4	604.1	5.5
Shares and stocks	17.2	32.5	49.7	2.1	91.7	161.3	253.0	2.3
Real estate and shares therein	140.1	104.6	244.7	10.5	1 039.6	692.1	1 731.7	15.9
Total	1 470.8	857.2	2 328.0	100.0	7 680.2	3 230.2	10 910.4	100.0

are also significant and their share at present exceeds 50 per cent. The loan period of most of the loans granted by the insurance companies is 6 or 10 years. In the case of housing loans, longer-period loans are granted if the borrower has obtained a state housing loan.

The average rate of interest varies at present, and is between 10 and 11 per cent depending on the purpose. The most general rate of interest on housing loans is 9.25 per cent, for industry 10.25 per cent, while the rate is 10.75 per cent on other business loans. The insurance companies agree with the Bank of Finland on corresponding changes of the interest rates when the central bank rates have been raised or lowered.

REVENUE AND EXPENSES OF FINNISH INSURANCE COMPANIES

The major part of the insurance companies' revenue consists of premiums and return on

reinsurance. The largest items of expenses are settlements, increases in insurance reserves and the costs of reinsurance.

The most characteristic change in the structure of insurance company expenses during the period under review is the decline from 14 per cent to 10.5 per cent in the share of operating expenses. At the same time the relative share of expenses due to insurance activity proper has increased from 83.5 per cent to 86.3 per cent. See Table 5.

The percentage share of capital revenue in total revenue has increased markedly during the decade under review.

Changes in the profits reflect the development of the insurance sector during the period under review — the deterioration of the loss ratio has been partly compensated for through rationalization and yield from investments.

TABLE 5. BREAKDOWN OF INSURANCE COMPANIES' REVENUE AND EXPENDITURE

	1965				1975			
	Pension and life insurance	Non-life insurance	Total	Per cent	Pension and life insurance	Non-life insurance	Total	Per cent
	Mill. mk							
Revenue								
Premiums	338.9	615.6	954.5	71.9	2 100.9	2 353.4	4 454.3	77.6
Reinsurance	7.6	152.9	160.5	12.1	16.9	330.4	347.3	6.1
Capital revenue	109.9	79.3	189.2	14.3	600.1	311.9	912.0	15.9
Other revenue	1.0	21.7	22.7	1.7	0.8	20.5	21.3	0.4
Total	457.4	869.5	1 326.9	100.0	2 718.7	3 016.2	5 734.9	100.0
Expenditure								
Compensations paid	88.2	370.7	458.9	34.6	1 090.8	1 414.2	2 505.0	43.8
Increase in risk liabilities	294.2	149.9	444.1	33.5	1 379.7	673.2	2 052.9	35.8
Reinsurance	6.4	197.8	204.2	15.4	15.8	370.7	386.5	6.7
Operating expenses								
Salaries	31.3	74.1	105.4	7.9	90.7	249.7	340.4	5.9
Other	28.7	49.4	78.1	5.9	78.0	186.7	264.7	4.6
Taxes and public fees	4.5	10.5	15.0	1.1	26.7	31.8	58.5	1.0
Other expenses	2.1	7.2	9.3	0.7	33.9	66.2	100.1	1.7
Profit	2.0	9.9	11.9	0.9	3.1	23.7	26.8	0.5
Total	457.4	869.5	1 326.9	100.0	2 718.7	3 016.2	5 734.9	100.0

CO-OPERATION BETWEEN FINNISH INSURANCE COMPANIES

The common interests of the Finnish insurance companies are guarded by the Federation of Finnish Insurance Companies. It a) supervises insurance activity in Finland, its development and its service to society, b) follows the development of legislation on insurance companies, c) maintains connections with other organizations and authorities, prepares reports and makes proposals, d) endeavours to shed light on the aims and significance of insurance activity and e) aids its members in other matters which it is able to undertake or which are of general interest. In addition, the Federation represents Finnish insurance companies within the Nordic countries and internationally. Practically all the insurance companies are members of the Federation.

The Information and Training Centres of Finnish Insurance Companies operate within the Federation of Finnish Insurance Companies. The insurance companies representing different fields of insurance activity — life insurance, property insurance, employment accidents insurance, personal accident insurance, motor insurance,

employment pension insurance — have their own co-operative organs. There is also a rehabilitation centre run jointly by three of these organs.

The following insurance pools are in operation: The Finnish General Insurance Pool, The Finnish Atomic Insurance Pool, two pools for the insurance of employment accidents, two pools for motor insurance, The Nordic Pool of Aviation Insurers, The Finnish Pool of Aviation Insurers and the Employees Group Life Assurance Pool.

INSURANCE COMPANY SUPERVISION

There is a department within the Ministry of Social Affairs and Health which is charged with the supervision of insurance companies. The Ministry has the right to inspect these companies and require information on their activities. If the Ministry finds that an insurance company fails to observe the law, the scope of its licence or its articles of association, the Ministry may forbid the company to underwrite new policies. In certain cases the Government may also restrict or revoke the licence of a company.

FINNISH MORTGAGE CREDIT INSTITUTIONS

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SOME SPECIAL FEATURES OF MORTGAGE CREDIT INSTITUTIONS

Mortgage credit institutions have existed for more than a hundred years in Finland. These institutions have specialized in granting long-term credits, which are mainly against mortgage guarantees. The mortgage constitutes a conditional right to the borrower's property and is valid only if it is confirmed in court. The property which is mortgaged, however, remains in the possession of the borrower.

The mortgage credit institutions raise the major part of the finance needed for their lending through bond issues. Because bonds are repaid according to fixed redemption schedules, the granting of mortgage bank credits is also planned beforehand. The mortgage credit institutions may make some use of short-term credits as well, but they are not allowed to accept deposits from the public.

Finnish bank legislation, including a law governing the mortgage banks, came into force at the beginning of 1970. The law on mortgage banks contains detailed stipulations on the legal form and functions of mortgage banks. The Bank Inspectorate ensures that this law is observed. The Bank Legislation Committee submitted its report on the revision of the bank legislation to the Ministry of Finance in November 1976. The revision of the bank laws also include the Finnish mortgage credit institutions, but primarily it was a question of technical revisions.

The four major mortgage credit institutions are governed by the law on mortgage banks and have the legal form of joint-stock companies. One minor institution is governed by the law on mortgage societies and another minor one by the law on residential mortgage societies.

A mortgage bank is a joint-stock company which can be established by five corporate bodies (joint-stock companies, co-operatives, foundations, etc.) or at least ten Finnish citizens. A licence from the Ministry of Finance is needed for the establishment of a mortgage bank. Before granting this, the Ministry consults the Bank Inspectorate. The law contains some special stipulations concerning the articles of association for a mortgage bank.

The share capital of a mortgage bank must be a minimum of 2 million marks. In addition, there are stipulations concerning a mortgage bank's solvency: capital accounts must, after the deduction of certain claims, amount to at least 4 per cent of total liabilities.

MORTGAGE CREDIT INSTITUTIONS

At present there are six mortgage credit institutions in Finland. In the 1920s and 1930s there were slightly more, but the number has been reduced because of increasing rationalization and the small size of the Finnish capital market. Four are backed and owned by various groups of banking institutions.

The existing Finnish mortgage credit institutions are listed below, together with the year in which they were established and their total assets:

	Year of establishment	Dec. 31, 1965 Mill. mk	Dec. 31, 1975 Mill. mk
Industrial Bank of Finland Ltd	1924	295.1	1 530.9
Mortgage Bank of Finland Oy	1956	404.4	1 116.4
Finnish Real Estate Bank Ltd	1907	41.3	915.0
Land and Industrial Mortgage Bank Ltd	1916	105.2	827.7
Finnish Mortgage Society	1860	78.0	130.7
Residential Mortgage Bank of Finland	1927	5.7	6.6

The Industrial Bank of Finland Ltd and the Mortgage Bank of Finland Oy grant long-term investment credits mainly to industrial concerns. The former, which is owned by the commercial banks, has expanded its activity considerably in the last few years. The Mortgage Bank of Finland Oy, a subsidiary of the Bank of Finland, was set up to channel funds from foreign capital markets to Finnish industry. The Finnish Real Estate Bank Ltd is the mortgage bank of the savings banks. It grants credit to municipalities and owners of real estate in both urban and rural districts. The Land and Industrial Mortgage Bank Ltd is owned by the co-operative banks and grants long-term finance to agriculture, industry and municipalities.

The mortgage banks of the commercial banks, savings banks and co-operative banks have sometimes co-operated when arranging foreign loans to finance their lending to municipalities. In 1969 and 1971 they made two joint bond issues in the Federal Republic of Germany and in 1972 and 1974 in the U.S. market.

The other two mortgage credit institutions, the Finnish Mortgage Society and the Residential Mortgage Bank of Finland are associations, not joint-stock companies. The former is governed by the law on mortgage societies passed in 1925, and the latter by the law on residential mortgage societies passed in 1927. These institutions provide finance for the owners of real estate. The Finnish Mortgage Society operates mainly in rural districts and the Residential Mortgage Bank of Finland in urban areas. However, these two mortgage credit institutions are of minor significance.

SOURCES OF FUNDS

The mortgage credit institutions finance their credit-granting through bond issues and, more recently, through privately placed loans on the international capital markets. The Finnish capital market is small, and the role of the State is dominant. These features have meant that the mortgage credit institutions have not been able to raise sufficient funds from this source, and

consequently they have not been able to meet satisfactorily the demand for long-term credit from all the different sectors.

The legislation on the tax treatment of bonds was revised in 1969. As a result of the revision, the same tax exemptions are granted to private holders of both government and non-government bonds. Non-government issuers, such as mortgage credit institutions, need the permission of the Council of State to launch bond issues.

Government issues account for almost half of the domestic bond issues. However, since 1969 there has been a sharp increase in the share of non-government bond issues, especially by mortgage credit institutions.

Mortgage credit institutions' domestic bonds outstanding in 1975 totalled 2 196 million marks. The corresponding figure 10 years earlier was 347 million marks. The foreign bond issues of these institutions have also increased in the 1960s and 1970s; the Mortgage Bank of Finland Oy and the Industrial Bank of Finland Ltd have been especially active in launching bond issues abroad. The total of outstanding bonds in foreign currency of Finnish mortgage credit institutions was 1 120 million marks in 1975, as against 309 million marks in 1965.

TABLE 1. BREAKDOWN OF TOTAL LIABILITIES OF MORTGAGE CREDIT INSTITUTIONS

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Bond issues	654.0	70.3	3 319.4	73.3
Loans from the central government	71.1	7.7	89.1	2.0
Other loans	119.6	12.9	311.4	6.9
Share capital, reserve funds and debentures	53.7	5.7	118.8	2.6
Other liabilities	31.3	3.4	688.6	15.2
Total	929.7	100.0	4 527.3	100.0

The table reveals that 73 per cent of all liabilities consist of bonds. The shares of the other sources of finance are of approximately equal size. The significance of the latter, however, varies considerably between various mortgage

credit institutions. The greater part of central government loans have been granted to the Finnish Mortgage Society.

ALLOCATION OF FUNDS

Long-term loans on mortgages make up the major share of credits granted by mortgage credit institutions.

TABLE 2. BREAKDOWN OF TOTAL ASSETS OF MORTGAGE CREDIT INSTITUTIONS

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Outstanding loans	899.4	96.8	4 123.7	91.1
Bonds and shares	13.1	1.4	20.5	0.5
Claims on domestic banks and cash	7.8	0.8	353.9	7.8
Other assets	9.4	1.0	29.2	0.6
Total	929.7	100.0	4 527.3	100.0

Industry has received more than half of the total loans, and the share of the wood and paper industry has been especially large. Of other recipients of these loans, the more important are municipalities, residential real estate, and electricity, gas and water. Municipalities in particular have increased their share in the 1960s. This is due to the tightening financial position of many municipalities, which has increased the need for long-term investment credits. On the other hand, the share going to electricity, gas and water, as well as to certain other recipients has declined.

TABLE 3. CREDITS GRANTED TO THE PUBLIC BY MORTGAGE CREDIT INSTITUTIONS, BY SECTOR

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Industry	548.2	60.6	2 374.3	57.5
Electricity, gas and water	160.6	17.7	188.9	4.6
Real estate	68.8	7.6	346.3	8.4
Municipalities	43.5	4.8	770.7	18.6
Other	84.4	9.3	451.5	10.9
Total	905.5	100.0	4 131.7	100.0

The share of mortgage credit institutions in total outstanding credits was 6.4 per cent. Ten years earlier this share was 6.2 per cent and in 1955 only 1.6 per cent.

REVENUE AND EXPENDITURE OF MORTGAGE CREDIT INSTITUTIONS

Because of the nature of the mortgage credit institutions' activities, interest revenue and expenses play a more important role in their accounting than in other banks. At the end of 1975, the number of personnel in the mortgage credit institutions was 69. Their other management expenses are also rather small. The Finnish mortgage credit institutions' revenue and expenditure in 1965 and 1975 are shown below.

Approximately 92 per cent of total revenue of mortgage credit institutions is derived from interest on lending. Correspondingly, 85 per cent of their total expenditure consists of interest expenses on bond issues and on other loans. The difference between interest revenue and expenditure was only 27.2 million marks in 1975. Thus the margin between the interest rates on lending and borrowing is very small.

TABLE 4. DISTRIBUTION OF THE REVENUE AND EXPENDITURE OF MORTGAGE CREDIT INSTITUTIONS

	1965		1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Revenue				
Interest revenue on loans	52.9	91.7	338.4	92.3
Other interest revenue	3.0	5.2	11.7	3.2
Other revenue	1.8	3.1	16.5	4.5
Total	57.7	100.0	366.6	100.0
Expenditure				
Interest expenses on bonds etc.	52.3	90.6	311.2	84.9
Taxes	1.4	2.4	9.7	2.6
Salaries and wages	1.0	1.7	4.4	1.2
Other expenses	1.6	2.8	16.0	4.4
Depreciation	0.2	0.4	15.5	4.2
Profit	1.2	2.1	9.8	2.7
Total	57.7	100.0	366.6	100.0

Taxes make up a substantial part of the expenses after the deduction of interest costs; they accounted for 2.6 per cent of total expenditure in 1975. Salaries and wages totalled 1.2 per cent of total expenditure, which is considerably less than in other credit institutions. The share of profit in total expenditure

for 1975 was 2.7 per cent. However, there were great differences in the rates of profit among the various mortgage credit institutions.

FUTURE PROSPECTS

The mortgage banks have no central organization. Because of their small number it is possible for these institutions to co-operate directly. Contacts are usually needed in questions taken up by the Bank Inspectorate or in such matters as taxation. However, there are considerable differences among the various mortgage banks in respect to their other activities, as can be seen from, for example, the distribution of their credits among different types of recipients.

In the bank legislation, attention has been paid to increasing the efficiency of mortgage banks. Consequently the mortgage banks are now allowed to grant credit to a limited extent on guarantees other than mortgages. The law on bonds and debentures, which came into force at the beginning of 1970, considerably eased the acquisition of capital funds by the mortgage banks. Future prospects are favourable for the mortgage banks; their outlook will, however, be significantly influenced by the development of the Finnish capital market.

The growth of the business activities of the mortgage credit institutions was quite rapid at the beginning of 1970s, due to the economic boom and favourable saving development which enabled a successful issuing of new bonds. Bond issues were also made abroad more than before. Moreover, the favourable development of public finance decreased the

State's need to raise loans in the domestic capital market.

However, the situation changed during 1975—1976. The economic depression, because it lasted so long, did not ease the position in the domestic capital market after the oil crisis. The considerable tightening of public finance led to increasing borrowing from the domestic bond market, and correspondingly the share of new loans that goes to the mortgage credit institutions decreased considerably.

The tightening of competition was seen not only in the structural change, but also in the stipulations regarding bonds. The interest rate on the bonds exempt from taxes for sale to the public reached 11 per cent and over. Moreover, the State in particular has been using shorter term loans than before, even 5 year loans, as a means to increase its bond sales.

If the economic situation remains depressed for a long time, the recovery of saving and the extension of the bond market will be more difficult even though the preference for bonds has clearly increased during the depression, at the expense of shares.

The mortgage credit institutions have been active on the international capital market where it has been possible to make bond issues on quite favourable terms. The stringent financial policy of the Bank of Finland and the restraining of foreign loans so as to achieve a current account balance, have to some extent moderated the acquisition of foreign capital by the mortgage credit institutions.

FINNISH DEVELOPMENT CREDIT INSTITUTIONS

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BACKGROUND AND CHARACTERISTICS

Development credit institutions are one of the most recent types of financial institutions in Finland. The Industrialization Fund of Finland Ltd (Teollistamisrahasto Oy) and Finnish Export Credit Ltd (Suomen Vientiluotto Oy) were the first to be established. Although the former was founded in 1954, it only evolved into a development credit institution in 1963. The Tourism Development Fund of Finland Ltd was established in 1965 but this institution was merged with the Industrialization Fund in 1973. The establishment of the Regional Development of Finland Ltd (Kehitysalue-rahasto Oy) in 1971 marked another significant step in the evolution of specialized credit institutions. The Investment Fund of Finland, which was set up in 1975, will be dealt with separately at the end of this article.

Special credit institutions have been set up in a number of highly industrialized countries to encourage the establishment and operations of small and medium-sized industries. The Finnish development credit institutions have also been formed to achieve these goals and to satisfy the demand for credit of certain specific sectors of the economy. Recently they have also been devoting their attention to specific regions.

Credit is generally only granted after a thorough assessment has been made of its potential impact on production and the economy as a whole. Apart from finance, the development credit institutions provide consultative services for their customers.

In law, these institutions (excl. the Investment Fund of Finland) are constituted as joint-stock companies. The Industrialization Fund of Finland and Finnish Export Credit are governed by the Credit Company Act which came into force at the beginning of 1970 (the Regional

Development Fund was created by special legislation). A permit from the Ministry of Finance is required to establish such a company and its activities are supervised by the State through the Bank Inspectorate. While their activities are not as strictly regulated by law as are those of other financial institutions, their solvency requirements are more stringent. Their capital accounts must total at least 20 per cent of their total liabilities after the deduction of certain debit items, whereas the corresponding requirement for other credit institutions is usually 4 per cent. Investments in the equity of other corporations must not exceed the total of their capital accounts.

The shareholders of these institutions are banks, insurance companies, the central government, various organizations and business enterprises. As all the development credit institutions function as joint-stock companies, the highest decision-making authority is the shareholders' meeting. In addition, each institution has its Supervisory Board and Board of Directors.

The total number of people employed by development credit institutions increased from 48 to 204 between 1970 and 1975. As these institutions have very few branch offices, their administration costs are fairly low.

The share capital and total assets of the three Finnish development credit institutions are shown in Table 1.

TABLE 1. SHARE CAPITAL AND TOTAL ASSETS OF DEVELOPMENT CREDIT INSTITUTIONS

	Share capital		Total assets	
	Dec. 31, 1971	Dec. 31, 1975	Dec. 31, 1965	Dec. 31, 1975
	Mill. mk	Mill. mk	Mill. mk	Mill. mk
Industrialization Fund of Finland Ltd	40.0	53.0	59.3	898.2
Regional Development Fund	30.0	160.1	—	649.2
Finnish Export Credit Ltd	36.0	36.0	143.5	1 916.6

The table reveals that the total assets of the development credit institutions have increased remarkably during the last ten years.

INDUSTRIALIZATION FUND OF FINLAND LTD

The shares of the Industrialization Fund of Finland Ltd are owned by Finnish banks, insurance companies and other organizations. In addition, foreign banks and finance companies owned 18.9 per cent of the series A shares at the end of 1975. The Industrialization Fund mostly channels its resources to small and medium-sized industries and the development of tourism. The most important criteria used in the selection of projects to be financed are the expected yield from the investment, the future prospects of the company and the social return on the investment. Lending decisions are based on a thorough investigation of the firm and project in question. Apart from carrying out these investigations, the Industrialization Fund provides consultative services in financial and management problems. Sectoral surveys of industries are carried out in order to assess and evaluate the credit applications of companies. In addition, the gathering of follow-up data on clients provides a further basis for comparing the various industrial sectors.

In 1975 the average size of loans granted by the Fund was 1.6 million marks and the average loan period 9.6 years. The average rate of interest was about 10.8 per cent.

FINNISH EXPORT CREDIT LTD

In Finland, medium and long-term export credits are financed by Finnish Export Credit Ltd, a joint-stock company whose shares are held by the State, banks and several industrial enterprises engaged in export. The company's principal sources of funds are the sale of subordinated debentures to the central government and shareholding banks, and borrowing in the domestic and international capital markets. The company's primary purpose is to promote exports of Finnish industrial products by financing medium and long-term export credits and pre-delivery costs. In addition to ordinary commodity exports, the company also finances

foreign leases of Finnish equipment, construction projects abroad using Finnish goods and services, as well as the setting-up of consignment stocks abroad.

Advances are given against promissory notes, and repayment schedules are drawn up at the time they are granted. These advances cover about 85 per cent of the export credit required. The rate of interest is determined when credit is granted and remains unchanged over the whole period. In 1975 the minimum lending rate on export credits was 8 per cent.

REGIONAL DEVELOPMENT FUND

The share capital of the Regional Development Fund has been 160 million marks since 1975. The State owns 99.9 per cent of the capital stock and the remainder is held by 29 shareholders. The Fund aims to support certain industries in development regions, primarily small-scale manufacturing industries and tourism. The Fund grants various kinds of financial support, provides consultative and training facilities and carries out research. By the end of 1975, loans granted by the Regional Development Fund totalled 672 million marks. In addition, loans and grants totalling 20.9 million marks were given for research and development projects during the period 1971—1975. The average size of loan granted was 300 000 marks and the average loan period 8 years with an average interest rate of 10.5 per cent.

SOURCES OF FUNDS

Table 2 shows the distribution of the liabilities of development credit institutions for the years 1965 and 1975.

TABLE 2. BREAKDOWN OF TOTAL LIABILITIES OF DEVELOPMENT CREDIT INSTITUTIONS

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Current liabilities	39.3	18.8	91.0	2.6
Debentures	113.0	54.1	1 661.8	48.0
Bonds, issues and other long-term loans	32.2	15.5	1 308.1	37.8
Share capital	22.8	10.9	385.9	11.1
Other liabilities	1.4	0.7	17.1	0.5
Total	208.7	100.0	3 463.9	100.0

As the Finnish capital market is rather small and not fully evolved, development credit institutions have not been able to raise finance through publicly-issued domestic bonds. Debentures have therefore been their major source of finance; the share of this type of financing was 48.0 per cent in 1975, as against 54.1 per cent in 1965. These debentures give a claim on the company's funds after the deduction of their liabilities, and thus they are comparable to the company's capital accounts when allowance is made for the solvency requirements. Shareholder banks and the State have been the primary subscribers to these debentures.

All issues of debentures by the development credit institutions have been made in Finland. In addition, all three institutions have raised funds abroad through bank loans and private placement. The Industrialization Fund and Finnish Export Credit have also raised funds abroad through public bond issues.

ALLOCATION OF FUNDS

Table 3 indicates that so far the development credit institutions' investments, other than lending, have been of minor importance.

At the end of 1975, long-term and medium-term loans comprised almost 90 per cent of the total assets of the development credit institutions. In addition, they held equity investments totalling only 23.3 million marks in 1975. Because of the need for adequate liquidity, 5.5 per cent of the total funds were held in bank accounts.

TABLE 3. BREAKDOWN OF TOTAL ASSETS OF DEVELOPMENT CREDIT INSTITUTIONS

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Outstanding loans	167.7	80.4	3 104.2	89.6
Equity investments	0.3	0.1	23.3	0.6
Claims on domestic banks and cash	25.8	12.4	186.5	5.5
Other assets	14.9	7.1	149.9	4.3
Total	208.7	100.0	3 463.9	100.0

TABLE 4. CREDITS GRANTED BY DEVELOPMENT CREDIT INSTITUTIONS, BY INDUSTRY

	Dec. 31, 1965		Dec. 31, 1975	
	Mill. mk	Per cent	Mill. mk	Per cent
Manufacture of machinery	93.1	68.5	926.0	28.7
Manufacture of electrical machinery and equipment	2.6	1.9	67.5	2.1
Shipbuilding industry	—	—	965.9	29.9
Manufacture of other transport equipment	3.4	2.5	54.7	1.7
Manufacture of metal products	11.3	8.3	226.9	7.0
Other manufacturing	25.2	18.5	786.5	24.3
Tourism	0.4	0.3	204.9	6.3
Total	136.0	100.0	3 232.4	100.0

As can be seen from Table 4, most of the lending by the development credit institutions goes to manufacturing. This financing has contributed substantially to a rapid diversification of the country's industrial structure — traditionally mainly based on forestry.

Advances outstanding have grown rapidly in the last few years. At the end of 1975, their share in the outstanding advances of all credit institutions was 5.3 per cent, as against only 1.0 per cent at the end of 1965.

REVENUE AND EXPENDITURE OF DEVELOPMENT CREDIT INSTITUTIONS

Development credit institutions derive the greater part of their revenue from interest income, commitment fees and commissions. Likewise, interest payments form a significant proportion of their total expenditure.

Table 5 shows the distribution of the revenue and expenditure of the development credit institutions. Income from interest charges has gone up considerably and in 1975 it formed nearly 92 per cent of total revenue. On the expenditure side, the item »Other expenses» increased substantially, mostly because of the payment of miscellaneous debt service charges in both the domestic and foreign financial markets.

TABLE 5. DISTRIBUTION OF REVENUE AND EXPENDITURE OF DEVELOPMENT CREDIT INSTITUTIONS

	1965		1975	
	Mill .mk	Per cent	Mill. mk	Per cent
Revenue				
Interest revenue on				
loans	6.7	77.9	259.8	91.8
Other revenue	1.9	22.1	23.1	8.2
Total	8.6	100.0	282.9	100.0
Expenditure				
Interest expenses	5.6	65.1	176.6	62.4
Salaries	0.4	4.7	9.2	3.3
Depreciation	0.1	1.2	7.5	2.6
Taxes	1.0	11.6	11.2	4.0
Other expenses	0.6	7.0	62.0	21.9
Profit	0.9	10.4	16.4	5.8
Total	8.6	100.0	282.9	100.0

CO-OPERATION OF DEVELOPMENT CREDIT INSTITUTIONS

Finnish development credit institutions have no central organization of their own. This has not been deemed necessary because their number is very small and all of them are quite specialized. Co-operation has been considered quite adequate, since the same individuals serve on the boards of several institutions. There has also been close co-operation in the field of research and the training of personnel.

THE INVESTMENT FUND OF FINLAND

The act of Parliament establishing the Investment Fund of Finland came into force on February 7, 1975. The purpose of the Fund's lending is to a large extent, similar to that of development credit institutions.

The Fund was set up to finance productive investments in both publicly and privately-owned enterprises. Projects are financed on the criteria that they are profitable, that they promote balanced regional growth and increase international competitiveness. A substantial proportion of the loans have been channelled to large companies in the industrial and energy sectors. At the end of 1976, credits granted by the Investment Fund of Finland amounted to 880 million marks.

The Fund is administered by the Treasury and its lending activities are managed by Posti-pankki. At present, the Fund's lending limit is 3 500 million marks out of which 500 million marks is equity capital transferred to the Fund from the State budget. 1 000 million marks has already been raised in foreign capital markets on the account of the State.

THE HELSINKI STOCK EXCHANGE

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FOUNDATION AND ORGANIZATION

In 1912, a number of Helsinki merchants founded the Helsinki Stock Exchange. They had a building constructed and donated it to the newly established institution. In the 19th century, trading in securities had taken place in Helsinki according to the continental pattern, but this activity had not led to the establishment of a permanent stock exchange.

The Helsinki Stock Exchange played an important financial role up to 1920. Indeed, if adjustments are made for inflation, it becomes clear that annual turnover on the Stock Exchange at that time was nearly three times as large as it was at the beginning of the 1970s.

The number of stockbrokers, which at one time reached 66, has also dropped and at present there are 12 members of the Stock Exchange. In the 1930s the Helsinki Stock Exchange was transformed into a »silent» stock exchange, on the lines of the Stockholm Stock Exchange. Small stock exchanges are usually »call-over» exchanges. In a silent stock exchange the bidding and offering are carried out electro-mechanically. The brokers present their bids and offers by pushing buttons on their desks and these are then displayed on a lighted board. The convergence of bids and offers indicates that a transaction is taking place, and the size of the transaction is stated by the brokers. The chairman of the session confirms the completed transaction by reading aloud the names of the parties, the price and the quantity exchanged. After the first transaction is completed, the same security will be quoted until there is no further trading in it. It is then possible to quote buying and selling rates, which are confirmed by the chairman of the session.

The daily session of the Helsinki Stock Exchange comprises the »call-over» time, during which prices are fixed, and the »after-session», which is reserved for very big or very small deals. This phase is, however, of minor importance and the majority of the daily transactions are completed during the »call-over» time.

At the beginning of 1978 the Helsinki Stock Exchange listed the shares of 49 companies, some subscription rights, four debentures and 83 bonds of which 35 were issued by the Government, 39 by mortgage credit institutions, and 9 by industrial companies.

Parliament has never passed an act governing the activities of the Stock Exchange. The Rules of the Helsinki Stock Exchange were established when Finland was a Grand Duchy under the hegemony of Russia. The legal status of the Stock Exchange is comparable to that of an association. The Stock Exchange is controlled and administered by a 12-member Stock Exchange Committee. The procedure for the election of these members dates from the foundation: The Helsinki Chamber of Commerce elects six members, the Finnish Bankers' Association three members, and the brokers who do not belong to the Finnish Bankers' Association three members. The Committee decides whether new securities will be listed and also appoints the brokers. The Rules of the Stock Exchange give the Stock Exchange Committee a fairly free hand in deciding the listing of new securities. In 1927 the Committee decided upon standards to be met before a company is listed: the company should be on a sound financial footing and have distributed dividends from profits during the preceding year; furthermore it should be likely that the securities will be traded.

In order to secure the future of the Helsinki Stock Exchange and boost its turnover, it is vital that new companies be listed and that their shares be traded. Furthermore, to promote trading and investment in securities, legislation governing investment funds must be brought in as soon as possible. A bill concerning investment funds was presented to Parliament in the spring of 1977.

Investment funds would encourage investment in shares by small savers, which in turn would increase the supply of securities and bring new investors into the market. In addition, as investment funds are able to invest a significant part of their capital in non-listed enterprises, they might foster new, expanding companies and push them into the Stock Exchange.

TURNOVER

During the first two decades of the Helsinki Stock Exchange, trading in securities was very lively. However, World War II and particularly its aftermath interrupted this activity. In the 1950s dealing in securities reached its low point at a time of strikes and other economic adversities. The downswing on the Stock Exchange continued into the 1960s, even though this period witnessed very favourable general economic development.

The evolution of the Stock Exchange in Finland has been affected by the concentration of private savings in bank deposits and by the large share of outside financing in total entrepreneurial investment. The small size of the Finnish securities market is as much a result of the prejudices of private investors as of the unwillingness of unlisted enterprises to increase the number of their shareholders. Furthermore, the effects of taxation should also be taken into account especially when comparing the costs to the enterprise of various types of finance.

However, in 1968 the trade in securities began to pick up, and this upward trend continued for five years. It was based mainly on the

economic turn-round produced by the devaluation in the autumn of 1967 and the subsequent stabilization policy. The rise on the Helsinki Stock Exchange continued until the autumn of 1973 after which the oil crisis and international depression had a dampening effect. The peak year was 1973 when the turnover was 291 million marks. After this, the strained money market, the decline in companies' profitability, the increase in debt and the state's restraining tax policy have influenced the turnover. In 1976 the turnover fell to 172 million marks and in 1977 to 191 million marks. The decline in turnover has mainly been due to the considerable decline in security prices. The decline in the number of transactions has been quite small.

TABLE 1. ANNUAL TURNOVER ON THE HELSINKI STOCK EXCHANGE, MILL. MK

	1965	1970	1973	1975	1976	1977
Shares	24.1	53.2	204.0	143.1	136.9	125.6
Subscription rights	4.7	9.2	61.4	48.7	16.4	1.8
Bonds	5.2	12.9	19.5	13.4	16.0	56.8
Debentures	0.5	1.9	6.2	2.7	2.8	7.3
Total	34.5	77.2	291.1	207.9	172.1	191.5

SHARE INDEX

The increased public interest in securities after 1967 has been the result of a large number of factors. In 1968 indexed deposit accounts were abolished; they had long been a favourite way to save as they were proofed against inflationary loss. However, it was thought that the indexing itself contributed to inflation, and so they were abolished. The shares of housing companies, which had been another popular way to save, lost their tax exemption and a part of the funds invested in these shares was redirected to other assets, such as securities listed on the Stock Exchange. This channelling of savings to securities has been encouraged by the information made available by the Stock Exchange and its members.

The changes in security prices, in the mid-1970s, while being similar to the changes in turnover, have not been so sharp. At the be-

ginning of the 1970s, security prices reached quite a high level, due to the low level at which they started and the small size of the security market.

Previously, security prices were not greatly influenced by changes in the domestic or international economy. The sharp rise in share prices was, however, followed by a long decline in 1973. The persistence of the international depression and the increasing difficulties faced by enterprises caused a further downward trend in prices. By 1977, security prices had dropped to the level of the early 1970s (see table 2; the Unitas share index is calculated by the Union Bank of Finland Ltd).

**TABLE 2. UNITAS SHARE INDICES
(1975 = 100)**

	1965	1970	1973	1975	1976	1977
Banks	35.3	35.4	130.8	100.0	86.6	64.7
Industry	29.6	48.9	114.3	100.0	89.7	67.2
Trade	—	59.8	131.9	100.0	94.2	92.3
General	31.2	46.1	119.9	100.0	89.1	67.9

TAXES AND OTHER TRANSACTION EXPENSES

Since 1945, capital on deposit and interest from deposits have been exempt from both central government and local taxes. In 1969 a similar tax exemption was extended to include bonds issued for public subscription, irrespective of the issuer of the bonds. Previously only Government bonds had been eligible for tax relief.

On the other hand, a sort of double taxation applies to shares. Shareholders pay a wealth tax on the shares they own, and then they normally pay income tax on dividend income. Each family member is entitled to tax exemption on 1 000 marks (500 marks up to 1977) of dividend income, but a 15 per cent exemption on all dividend income, that had earlier been allowed, was removed in 1972. These tax exemptions only apply to central government taxation.

At present, companies pay income tax on their profits at a rate of 43 per cent. In addition, there are local taxes and certain other levies which raise the total tax rate to 60 per cent. As an encouragement, the issuing of securities was exempted from stamp duty in 1969. The security market was bolstered by another reform under which dividends from an issue for cash qualify for tax relief during the year of issue and the five following years. At the same time, a further reform was carried out, which allows companies to deduct 40 per cent of distributed dividends in assessing income liable to central government taxation. This percentage was raised to 60 in the budget for 1978. These reforms led companies to issue an exceptional number of shares. There was, and still is, a great need for this development, as share capital was less than 24 per cent of the total assets of industrial companies in 1975. Fifteen years earlier the corresponding figure was 32 per cent.

The expenses paid by the investor on stock exchange transactions amount to 1.5 per cent of the value of the deal. The broker charges both the buyer and the seller a commission of one per cent and the stamp duty of one per cent is divided equally between the buyer and the seller. No stamp duty is levied on dealings in bonds. The stamp duty on transactions in unlisted shares is 1.2 per cent of the value of the deal.

Any increase in the value of securities is liable to tax, if the seller has owned the securities for less than five years. In contrast to the situation in many other countries, such capital gains are treated as earned income and taxed at the taxpayer's marginal rate. However, capital gains are exempted from tax if the securities were received as a gift, inheritance etc. The taxation of capital gains, coupled with other expenses, has reduced the attraction of short-term investment on the Helsinki Stock Exchange. Furthermore, speculation is largely held in check by the Rules of the Stock Exchange. There is no futures market, and securities may not be bought on margin.

SHARE ISSUES

The few cyclical down-turns of the 1960s hampered share issues. It was not until the incentives mentioned above began to have an effect that the companies started to increase their share capital in order to achieve a more balanced portfolio of assets. Most of the share issues have thus been aimed at changing a company's asset structure. However, share issues have also been used, to a greater extent than in the past, to finance investment at times when other financial markets have been tight.

Rights issues take two forms in Finland: the shareholder may receive the right to buy a certain number of shares at a fixed price (issue for cash) or he may receive shares free of charge (bonus issue). The issues for cash and bonus issues of companies listed on the Stock Exchange are shown by type of company in table 3.

TABLE 3. SHARE ISSUES OF COMPANIES LISTED ON THE HELSINKI STOCK EXCHANGE, MILL. MK

Year	Industrial		Banking		Other		Total		
	Cash	Bonus	Cash	Bonus	Cash	Bonus	Cash	Bonus	Total
1965	11	6	96	—	—	3	107	9	116
1970	93	68	56	—	18	—	167	68	235
1973	127	22	136	56	72	—	335	78	413
1975	333	200	—	—	6	—	339	200	539
1976	210	80	—	—	—	—	210	80	290

During the years of low economic activity in the middle of the 1960s, bonus issues were more important than issues for cash. In the 1970s there have been many issues for cash, although they have often been partly bonus issues to make them easier to place. Dividends have tended to only very slowly follow trends in the economy as companies have only infrequently altered the dividend rate. They have preferred to set aside a part of their profits in good years and distribute them in years of poor performance.

Table 3 shows that 1973—1975 were the peak years in the stock market. For quite a long time after the start of the depression issues continued to attract interest in the Finnish stock market.

The reversal did not take place until 1976, when the number of issues dropped by half and the level of security prices and turnover fell more sharply. At one point in the summer of 1977 there were no subscription rights on the list.

On the exchange list there have been very few changes. In the 1970s, six new companies have appeared. Correspondingly, three companies have dropped from the list due to mergers or purchase by the State. However, the share capital of all these companies was quite small. The share capital of quoted companies has mainly grown by share issues.

TABLE 4. THE SHARE CAPITAL OF COMPANIES LISTED ON THE HELSINKI STOCK EXCHANGE IN 1965 AND 1975, NOMINAL AND MARKET VALUE, MILL. MK

	1965		1975	
	Nominal value	Market value	Nominal value	Market value
Banks	228	320	831	1 622
Industry	626	1 054	2 442	5 279
Other	91	201	284	634
Total	945	1 575	3 557	7 535

TABLE 5. THE TEN MOST-TRADED SHARES IN 1975, 1 000 MK AND THEIR RANK IN 1975 AND 1965

Company	Value traded	1975		1965 Rank
		Rank	Rank	
The Union Bank of Finland	20 802	1	1	
Kansallis-Osake-Pankki	16 534	2	4	
Nokia	11 823	3	2	
Rauma-Repola	10 595	4	15	
Kymi Kymmene	9 549	5	3	
Wärtsilä	6 126	6	5	
Wilh. Schauman	5 949	7	39	
Enso-Gutzeit	5 723	8	12	
Lohja	4 746	9	10	
Kaukas	4 575	10	13	

The ranking of the companies does not fluctuate very much from year to year, however, the figures for a particular year may be greatly affected by a major transaction of a new issue. The statistics available indicate that only twenty companies have been in the »top ten» since the exchange was founded. Companies with a large share capital and many share-holders seem to stand out clearly from the rest.

Furthermore, table 5 indicates that the various groupings were well represented on the list of the most actively traded shares. The shares of industrial companies, which attract investors through frequent new issues, occupy a prominent position. Companies which pay a high dividend, particularly the commercial banks, are well placed in the table. If no new issue is expected in the near future, trading in the firms' shares is fairly smooth. Price fluctuations are not significant and the dividend rate is rather stable. Furthermore, the volume of trade in these shares makes them a fairly liquid investment.

TABLE 6. DISTRIBUTION OF THE SHARE CAPITAL OF THE COMPANIES LISTED ON THE STOCK EXCHANGE 1972

Groups of owners	Number of share-holders	Nominal value of shares owned	
		Mill. mk	Per cent
Companies and similar enterprises	10 500	267.0	14.8
Financial institutions	500	187.7	10.4
Public organizations	500	96.4	5.4
Private foundations	11 700	345.6	19.2
Private households	397 400	847.1	47.0
Foreign shareholders	2 700	57.1	3.2
Total	423 300	1 800.9	100.0

TABLE 7. DISTRIBUTION OF SHAREOWNERSHIP IN 1975 (PER CENT)

Category	Per cent owning shares
Total population (aged over 15)	7.3
Farmers	11.2
Blue collar workers	2.0
White collar workers	13.3
Income below 16 000 Fmk/year	6.1
Income 16 001—24 000 Fmk/year	6.0
Income over 24 001 Fmk/year	8.9
Large cities	11.8
Other cities	6.2
Rural communes	6.1

SHAREHOLDERS

The distribution of the share capital of the companies listed on the Stock Exchange has been reviewed three times. The results of the inquiry made in 1972 are shown in table 6. The number of shareholders has since increased because of share issues and there are now clearly more than half a million shareholders.

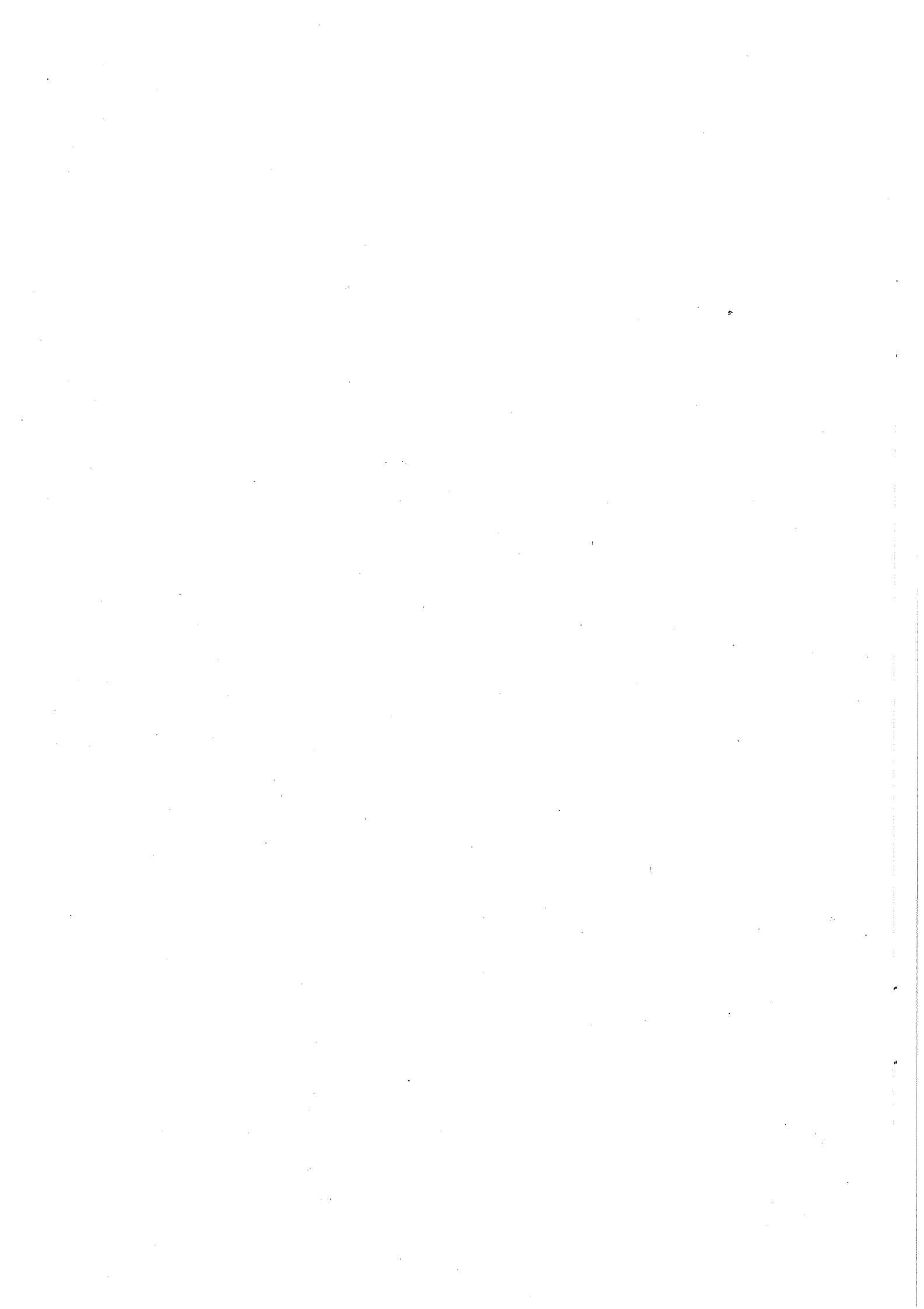
In 1972, private shareholders owned slightly less than half of the share capital of the companies listed on the Stock Exchange. The largest portfolios among the institutional investors were owned by foundations and associations (20 per cent), other companies and communities (15 per cent) and financial institutions (over 10 per cent). The State held about 5 per cent and foreign shareholders about 3 per cent. A considerable part of some companies is owned by the State — over 50 per cent of a certain company listed on the Stock Exchange — while others are almost free from State ownership. The same is also true to a great extent of foreign share holding.

In 1975, the Stock Exchange made a survey into the extent of shareownership in Finland. The results of this inquiry are shown in table 7.

According to the results, 7.3 per cent of the population aged over 15 years owned shares of the companies listed on the Stock Exchange. However, the shareownership greatly varies in different demographic classes. 7.3 per cent corresponds to about 254 000 shareowners.

The results of the survey also indicate that, on average, shareholders own the shares of two different Stock Exchange companies, which agrees with the information available from the register of the Stock Exchange companies.

Due to the recession, the Stock Exchange, which recovered strongly at the beginning of the 1970s, has returned to the state of uncertainty that prevailed in the 1960s, despite a heavy influx of investors. In particular, the adverse attitude of the State toward the tax reforms has resulted in savers turning to tax-free bonds more often. Consequently, the Central Government has been able to satisfy rapidly increasing need for credit in the domestic market. In order that the share market may recover, it is necessary for there to be institutional and tax reforms as well as general economic recovery.



ISBN 951-686-043-5

Helsinki 1978. Government Printing Centre

