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TRANSITION TO EXTERNAL CONVERTIBILITY OF THE FINNISH MARKKA

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1 Background

In 1958, Finland followed the other Western European countries in achieving external convertibility of its currency.[1] A short account is given below of the developments generating pressures for this move both in Finland and the other European countries. Some of the potential difficulties arising from these developments are also singled out.

1.1 Development in other countries

After the 2nd World War, pound sterling was considered to be the key to the achievement of the convertibility of the European currencies. The convertibility of sterling was regarded as a necessary condition for the introduction of convertibility by other countries. The British had stated as early as January, 1952 that convertibility was a definite objective, but was not imminent, their approach being to work towards this goal by progressive steps aimed at creating the conditions under which convertibility could be reached and maintained.

The cooperation of the countries in surplus was felt to be imperative in achieving convertibility. In addition to this, three conditions had been outlined for the achievement of convertibility: the healthy state of the economy, the adoption by trading nations of trade policies conducive to the expansion of world trade, and the availability of adequate financial support through the International Monetary Fund or otherwise (i.e. reserves).

As to the position of other European currencies, it was at first feared that sterling convertibility would be established by tightening trade restrictions. At the OEEC Ministerial Council Meeting in March, 1953, a consensus was achieved that progress towards trade liberalization should proceed parallel with progress towards convertibility.

There was awareness of the problems posed by the fact that not all European currencies were as equally

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1) The move to convertibility took place under fixed exchange rates. Thus the decision-making environment was markedly different from the present one.

2) Finland was not a member of the OEEC and did not directly participate in the preparations for the liberalization of trade and payments in Western Europe.

strong. Countries returning to convertibility might impose or intensify restrictions on imports from countries with weaker currencies that remained inconvertible for the time being. It was therefore essential that most, if not all, European countries should achieve convertibility simultaneously. The recognition of these problems was reflected as early as May, 1954 by the establishment of a ministeri examination group on convertibility at the OEEC Council Meeting. The group was to consider the problems that might arise for intra-European trade and payments if and when convertibility was introduced for one or more European currencies. Some pressure was exerted by the countries which had already attained strong payments positions as to the timing of the concerted move to convertibility. In Finland´s case, there was no immediate prospect in the early and mid-1950s of creating the necessary conditions for joining the concerted action.

In this context, it should also be noted that at that time there was no general agreement as to what difficulties countries might come up against in meeting their Fund obligations with respect to their bilateral payments agreements with countries that were not members of the Fund.[1)]

As to the progress made in creating the conditions necessary for transition to convertibility, the expansion of gold and dollar reserves outside the United States was essential. In this respect, by 1955 most of the abnormal post-war difficulties had receded into the past and with them had gone the acute payments problems. In response to these developments, steps were taken, particularly in Western Europe, to accelerate the reduction of restrictions. As a part of this process, controls were applied less rigorously. The OEEC had, by January, 1954, freed three-fourths of the trade conducted among the member countries, and in 1955 the liberalization of invisible transactions within the OEEC area was begun. In addition to these developments, there was a tendency to reduce the degree of discrimination. Also, in the summer of 1955, Western European countries began to terminate some of their bilateral payments agreements.

Pressure for trade liberalization and convertibility of currencies was mounting in the United States and Canada. By the mid-1950s, they had started to

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1) The present policy of the IMF is not concerned with the restrictions (e.g. bilateral payments agreements) that member countries have vis-à-vis non-member countries.

critize restrictions that discriminated against imports from the dollar area. The EPU settlements were so arranged that they tended to encourage tighter restrictions against the dollar area. There was doubt whether the IMF could tolerate indefinitely the policy followed by the EPU countries (i.e. earmarking dollar earnings for settlement of their deficits within the EPU). One factor also working in the same direction was the new IMF policies to assist members through renewed balance of payments crises so that need not tighten restrictions which they had previously relaxed. In the latter part of 1956 and in 1957 (after the Suez Canal crisis) the IMF lent substantial sums to its members (UK, France, the Netherlands and others). Consequently, these did not generally need to intensify restrictions.

After that the development towards convertibility culminated on December 27, 1958, when ten Western European countries[1]) made their currencies externally convertible for current transactions. Previously only ten countries had maintained convertible currencie It should be noted that none of the countries that had made their currencies externally convertible were yet ready to accept the obligations of Article VIII, Sections 2, 3 and 4, of the Fund Agreement. Their currencies were still inconvertible in the technical meaning of the Fund´s articles.

1.2 Consequent pressures on Finland

The above-mentioned developments were part of the inclinations in Western Europe towards a greater freedom of international trade. Even though it was not clear what form economic integration would take, it was feared in Finland that the continuation of trade restrictions might leave Finland isolated from her principal export markets. The external converti- bility decision of December 29, 1958 was not a single decision but rather a prerequisite for our action regarding the integration schemes and also a consequenc of the actions of other Western European countries.

Finland did not participate in the preparation of the integration plans at as early a stage as most of the other Western European countries. The structure of our foreign trade necessitated, however, a thorough study and follow-up of these developments. It was felt that by joining the concerted move to convertibility it would be possible to safeguard the vital interests of the country´s exports.

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1) Belgium, Denmark, France, Germany, Italy, Luxembourg, the Netherlands, Norway, Sweden, and the United Kingdom. These were shortly afterwards (on December 29, 1958) joined by Finland, Austria, Ireland and Portugal. Greece took the same step on May 25, 1959.

Finland´s export industry was at the time based chiefl on the timber, pulp and paper industry and the markets f these were in the west. The creation of the European Economic Community in itself was not a direct threat to Finnish export interests. Even though it was an important market for Finnish forest products, the principal competitors in the export of these commodities were also outside this area. Thus Finland was not placed in an unfavourable position with regard to her competitors. When the countries outside the European Economic Community began to plan their own free trade area, the situation became different.

The above-mentioned pressures were reflected in Finnish integration policy, a short account of which is given in Appendix I.

1.3 Policy goals

When considering the basic policy options as to future commercial policies, internal economic expansion, and the competitiveness of Finnish products in world markets in the late 1950s, Finland had to make a choic between two alternative lines of action: joining or not joining the general liberalization process of foreign trade and external payments (i.e. the "externa convertibility" of Finnish markka). Had we not followed suit, our economy would not have been able to diversify its exports. On the other hand, when facing common customs barriers, the slack growth of exports would also hinder economic growth and development. By joining the concerted action we safeguarded our position in the coming years.

From the allocation point of view, a change in development strategy was also involved. A conscious target of shifting resources toward sectors that have a high domestic value-added and a good export potential was set.[1] At the same time it meant that the import-competeing sector had to become more efficient. To this end, the exchange rate was fixed so that it protected home industries against foreign competition during the adjustment period.

Such a change in the growth strategy required that economic agents were given the right information as to the price of foreign exchange in real terms. It was seen as a more efficient way to allocate resources through the price mechanism than by quotas or restrictions that often mask the real price of foreign exchange (i.e. by an appropriate exchange rate; in the Finnish case the 1957 devaluation before the 1958 external convertibility decision established an appropriate level for the exchange rate).

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1) At the time only half of the allowable annual cut of Finland's forests was being utilized.

2 Prerequisites for joining the concerted move to external convertibility

In Finland it was felt that there were at least three necessary conditions: First, the general healthy state of the economy, second, proceeding with trade liberalisation (the latter because of the demands set by reciprocity in this field). A third condition was the adequacy of reserves, so that short-term disturbances in the external equilibrium could be coped with. However, the adequacy of reserves represents only the short-term view of the problem of maintaining external equilibrium. A long-term view would have to take into account the competitiveness of exports a as well as that of home market industries vis-à-vis imports. The preliminary actions taken in order to fullfil this condition as well are briefly accounted for below.

The devaluations carried out between 1945 and 1949 already aimed at re-establishing lasting price and cost relationships. On the other hand, this period can be characterised as a period during which foreign exchange policy (i.e. the devaluations) passively reflected the developments in domestic costs. A change in the attitudes of policy-makers was marked by the fact that the par value was established for the Finnish markka, which was simultaneously approved by the Fund in 1951, three years after Finland had joined the Fund.

The devaluations of the 1940s did not produce lasting results, because domestic inflation got out of hand. The effects that were aimed at when planning the 1957 devaluation were to be secured with the help of sufficiently tight monetary policy and the introduction of the export levy, which was a new instrument in the arsenal of Finnish foreign exchange policy.

One of the ultimate policy goals was to abolish the remnants of quantitative restrictions which had been carried over from the war time as a part of economic management.

This long-term goal also had a bearing on the relevant short-term considerations. As was mentioned above, some degree of external equilibrium would also have to be maintained in the transitory phase. There was a need for a new strategy for external balance without import licensing. This strategy would entail a shift away from import-intensive activities and towards activities with a high domestic value-added and a good export potential. Such a change in strategy requires that economic agents be given right information as to the price of foreign exchange in real terms. Hence, to allocate imports through the price mechanism was a difficult but unavoidable task that policy-makers had to face (q.v. chapter 3).

One symptom of the regulatory tendencies prevailing in the economy at the time was the multiple exchange rate system. There were different values for the markka depending on whether it were used for travel abroad or for other foreign transactions (as a complication there was also the Clearingkunta-markka, an arrangement within which the premiums and discounts implied subsidies). The differences in the price of currency in real terms were not limited to foreign exchange only. Due to extensive price regulations in the domestic economy as well, the purchasing power of the markka was quite different depending on the way it was used (e.g. rents).

The conditions for the move to external convertibility were actually fullfilled in time for Finland to join th concerted action. Sufficient reserves were formed owing to the surplus on the goods and services account and an inflow of capital. It was felt that the healthy state of the economy could also be maintained after the devaluation. The grounds for this were threefold: first, there was no full compensation clause in the wages agreement; second, the development of the prices for Finnish exports had already peaked; third, arrangements had been created for the neutralization of the windfall profits of export industries, which were expected on the grounds of the magnitude of the devaluation.

3 Factors contributing to the setting of the new exchange rate level in Finland in 1957

It is always difficult to assess the proper level of the exchange rate of a currency. Under the fixed exchange rate system a currency could have an exchange rate which was "out of line" for a long period provided that the country in question had ample foreign exchange reserves or practised stringent exchange controls. It was also possible for such a situation to be corrected either by means of economic policy or automatically.

After the devaluation of the Finnish markka had been deemed necessary and the preparations for securing the economic preconditions for its execution at an opportune time had been started, the evaluation of various indicators of the desirable level of the new official rate began. Because multiple currency practices were to be abolished at the same time and the liberalisation of foreign trade was aimed at, the task was a delicate one. As a member of the IMF, Finland also had responsibilities towards that institution. If a change in the par value was to be substantial, the permission of the Executive Board of the Fund was required.

Naturally, the developments in certain price indices and productivity in Finland were compared with those in various other countries. This method can, however, provide only an approximate estimate of the disparity of the exchange rate and it must be supplemented by other evaluations and considerations, for the weighting systems of indices differ, and economic conditions may rapidly change the result of the exercise.

As to the profit levels of export industries, seasonal factors complicated the derivation of information concerning the suitability of the official rate of the Finnish markka in 1955 - 1956. The forest industries managed quite satisfactorily because export demand was brisk. Other export industries did not experience as favourable conditions and the "Clearingkunta" mechanism was applied to subsidise these sectors by some 10 - 20 per cent.

Import demand was vigorous and led in 1956 to a situation where stringent restrictions were needed to safeguard diminishing foreign exchange reserves. Also, the demand for foreign currency for travel purposes was so great that it had to be curtailed although the price of foreign exchange for this purpose was about 50 per cent higher than the official rate. All the above indicators showed that the overvaluation of the Finnish markka seemed to be substantial.

A starting point for estimating the new appropriate level was the travel rate. It was broadly felt that it represented better the "purchasing power" of the currency. As the new par value also needed the confidence of the general public, it was necessary to establish it fairly close to the travel rate. To this end, the difference between the prevailing par value and the travel rate was first narrowed somewhat. Foreign currency for travel purposes was then about 42 per cent more expensive than the official rate.

The export industries had wanted devaluation for some years. Since the home market industries would also have to face foreign competition after the liberalisation of trade restrictions, the magnitude of the devaluation was greater than the mere profitability considerations of the export industries would have warranted. During the adjustment period, sterilization of part of the export proceeds was envisaged by the authorities. It was estimated that thereafter the

the previous hindrances of the overvalued currency for exports would give way to a healthy expansion of productive capacity in these industries.

The new par value was established on September 16, 1957 and the devaluation was fixed at 28 per cent. The new par value was approved by the IMF on the same day. Changes of the basic value of the Finnish markka since the war have been as follows:[1]

Date	Value of one markka in grams of gold	Devaluation in per cent	Number of markkas per US $	Change in the exchange rate against the US $
			0.4935	
31.05.1945		-42.8 %	0.8630	+74.9 %
27.07.1945		-28.6 %	1.2080	+40.0 %
16.10.1945		-11.2 %	1.3600	+12.6 %
05.07.1949		-15.0 %	1.6000	+17.6 %
19.09.1949	0.386379[2]	-30.7 %	2.3000	+43.8 %
16.09.1957	0.277710	-28.0 %	3.2000	+39.1 %
12.10.1967	0.211590	-23.8 %	4.1999	+31.2 %

After 20.12.1971 central rates in terms of U.S. dollars were established and after 1.4.1978 the official price of gold was abolished in the IMF system.

4 Transitional difficulties and stabilizing measures

In the devaluation year 1957, some of the quarterly growth rates were negative. During the transitory period, unemployment increased and the production of domestic industry declined, as did, in particular, private construction. There was no marked change in the situation before the latter part of 1958. To what extent this development can be attributed to factors exogenous to the economy is a difficult matter to resolve. However, it is clear that the devaluation during the latter half of 1957 was significant in helping the exports of the Finnish forest industry to maintain their positions in foreign markets.

1) For the sake of convenience, the sums expressed in Finnish markkas are expressed in terms of the new markka (1 new markka is 100 old markkas after 1960).

2) The initial par value was established with the IMF as from July 1, 1951.

As to the stability problems of the economy, it was felt that the most significant one likely to arise after the initial trade liberalisation measures and devaluation would be the transfusion into the economy of excessive liquidity endangering balanced growth.

The expectations of excessive liquidity were based on the magnitude of the devaluation. The size of the planned devaluation was greater than the mere profitability considerations of the export industries would have justified. Therefore a tight monetary poli stance was adopted, which in practice meant the tightening the rediscount quotas. Additionally, an export levy was introduced (this was a new instrument in Finnish foreign exchange policy). Mainly exports based on domestic raw materials fell within the scope of this measure. From the very beginning this measure was conceived as temporary. The proceeds from the levy were accumulated in a blocked account in the Bank of Finland and, in consequence, the financial markets tightened by the same amount.

The funds accumulated in this way were used for two purposes: to repay the government debt to the central bank and to lend funds to the export industries, especially to help it to finance the expansion of capacity in the forest industry.

Towards the end of 1958 and in 1959, when it was felt that the immediate inflationary impact of devaluation had been contained, a variety of expansive measures were applied in order to bring about a sufficient expansion in productive capacity. First, the temporar contractive measures that had accompanied the devaluation were allowed to lapse; the price freeze had been applied for quite a short period and the collection of export charges was terminated within a year.

Expansive measures to boost investment in export industries were resorted to towards the end of 1958 and during 1959. Monetary conditions were eased by the lowering of general interest rates on two occasions during this period. At the same time, the costs incurred by the banks as a result of credit expansion was moderated: rediscount terms were alleviated, including the lowering of the rediscount rate. In 1958-59, depreciation rights in the field of corporate taxation were extended twice. Towards the end of 1959, additional measures aimed at stimulating investment were implemented: investment funds were released and corporate tax was lowered.

The growth performance of the Finnish economy and the policy measures designed to stabilize that growth have been given in Appendix 2 for the time period 1957-1964 (these years covering at least an "extended medium term", starting from the devaluation year).

As to the goal of shifting resources towards sectors with a high domestic value-added and a good export potential, an account of the developments in the structure of the Finnish economy in 1960-79 is attached (as part of the Bank of Finland Monthly Bulletin, April 1981).

5 Developments in the restrictive system in connection with devaluation and transition to external convertibility

In late 1956 and during the first eight months of 1957, Finland had to increase restrictions on external payments in order to curb the balance of payments deficit, while she attempted to restore stability to the economy by means of measures in the fiscal and monetary fields. As a first step, the licencing of imports outside the automatic import lists was applied more strictly. In December 1956, import licenses in Western European currencies for automatic import for the period December 12, 1956 - March 31, 1957 were fixed at 80 per cent of the quarterly average value of such licenses issued for December 1, 1955-November 30, 1956. With effect as from January 21, 1957, the amount of foreign exchange that Finnish residents going abroad could buy without special application was reduced.

As almost the entire trade deficit in 1956 had occurred in Western European currencies, Finland found it necessary, toward the end of March 1957, to reduce further its imports from OEEC countries. The application of the bilateral trade agreements with these countries was suspended as from April 1, 1957 and the countries concerned, i.e., Austria, Belgium, (representing the Belgium-Luxembourg Union), Denmark, France, the Federal Republic of Germany, Italy, the Netherlands, Norway, Sweden, Switzerland and the United Kingdom, were invited to a conference to consider a Finnish proposal to combine all bilateral trade quotas in a new system of global quotas, while reducing licensing for imports from these countries by some 30 per cent compared with the 1956 level.

An agreement was reached in July 1957 retroactive to April 1, 1957 and valid to September 30, 1957 with the possibility of being extended. Under this new system, imports from the OEEC countries mentioned were divided into three groups: A, B and C. Group A consisted of a number of global quotas, each comprising a variety of commodities. Within each of these quotas the importer was free to select both the commodity to be imported and the country from which it would be obtained. Group B included individual import commodities for which specific licenses were required. The recipient of the licence was, however, free to purchase in any of the participating countries. Group C included those commodities for which import licenses were to be specifically granted on a discriminatory basis. It was stated, however, that in issuing those licenses the traditional interests of the participating countries would be taken into consideration.

Group A accounted for about 73 per cent; Group B for about 7 per cent; and Group C for about 20 per cent of what imports were planned from these countries.

On the one hand, the global quota procedure was thought to lend itself well as an instrument for a gradual but substantial easing of restrictions. On the other hand, it could be utilized as a way out from a situation in which restrictions caused by foreign exchange reserves threatened to make the prevailing trade arrangements inoperative. The global quota system, although reducing imports from Western European countries, removed individual trade quotas of bilateral trade agreements and introduced more nondiscriminatory import licencing as far as most imports from the Western European countries were concerned.

The aforementioned trade partners were willing to go into the arrangement, as it was clear to both sides that the measures would be temporary.

This new system also resulted in reduced discrimination vis-à-vis dollar imports. As in the case of the previous automatic licensing list, some of the items included in Group A or Group B were allowed to be imported from the United States and Canada. Dollar imports were included in the new list to a larger extent than previously in the automatic list.

As described in chapter 3 the par value of the Finnish markka was changed from Fmk 230 per US dollar, established on July 1, 1951, to Fmk 320 per US dollar on September 15, 1957 (in terms of the old markka). Simultaneously with the introduction of new par value, the tourist rate and Clearingkunta[1] arrangements were abolished and the exchange rate structure thereby unified. In connection with the devaluation, a special levy was imposed on most exports (q.v. chapter 4).

Following the devaluation, the Finnish Government announced that from October 1, 1957 a large number of goods included in a new automatic licensing list could be imported to Finland without quantitative restrictions from all countries, other than the dollar area, which do not impose quantitative restrictions on imports from Finland and which extend transferability facilities to Finnish holdings of their currency. Import licenses would still be required but would be issued automatically upon application. It was also stated that the import arrangements which would apply to goods not included in the new automatic licensing list would be announced later. At the time the new system went into effect, i.e., October 1, 1957, ten European countries [2] qualified for the above import treatment Therefore, they immediately enjoyed the automatic licensing privileges.

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1) An arrangement under which exporters of certain products received and importers of certain commodities paid a markka premium up to 20 per cent over the official exchange rate. During the years 1953-56 the demand for timber and timber products was so strong that the obvious overvaluation of the Finnish currency did not hinder the principal exports. However, in order to facilitate the exports of other products, especially of the metallurgical industry and agriculture the authorities resorted to the Clearingkunta device.

2) Austria, Belgium-Luxembourg, Denmark, Federal Republic of Germany, Norway, the Netherlands, Sweden, Switzerland and the United Kingdom.

The new commodity lists for automatic licenses covered about 75 per cent of Finland´s imports, on private account from these countries on a 1954 basis. Thus, beginning October 1, 1957 the greater part of Finnish imports from Western European countries was rendered virtually free of restrictions. The extension of a similar import system to Italy depended on the outcome of negotiations that were then under way. France, which had earlier withdrawn multilateral payments facilities from Finland, could not benefit from the new automatic licensing. Trade between the two countries reverted to the old bilateral trade and payment agreements.

Imports from other OEEC countries, e.g., Iceland, Ireland, Greece, Portugal (only to March 14, 1958), and Turkey, continued to be conducted as previously according to the bilateral agreements. Such, also, was the case with other countries with which Finland had trade and payments agreements.

Effective December 9, 1957 Finland introduced basic changes into its automatic licensing system, thereby liberalizing it further. The great majority of goods in the automatic licensing list of October 1, 1957 and its later supplements, were transferred to a new free list and were exempted from import licensing. This liberalization of imports applied to all countries which had similarly freed Finnish exports from quantitative restrictions and had granted transferability to Finnish export earnings. But the regulation specifically excluded the dollar area from its operation.

On the same day that the new system went into effect, i.e., December 9, 1957, Finland entered into a new multilateral trade and payments arrangement with the following OEEC countries: Austria, Belgium (representing the Belgium-Luxembourg Economic Union), Denmark, Federal Republic of Germany, Italy, Norway, the Netherlands, Sweden, Switzerland and the United Kingdom. The agreement was left open for the adherence of Portugal, which signed it on March 14, 1958. Under this arrangement, the participating countries agreed to extend OEEC liberalization to imports from Finland and to confer transferability to all

Finnish export earnings, among the participating countries. Finland in turn undertook to maintain liberalization on imports from participating countries at an average level of 75 per cent as a minimum.

For the unliberalized portion of the imports from these countries, a global quota system similar to the one applied earlier was introduced. The operation of the above agreement was made retroactive to October 1, 1957 and remained in force until March 31, 1958 when it was extended until the end of 1958. Even after this a small automatic licensing list was still applicable to countries which were parties to the Protocol of December 9, 1957 and to the rest of the sterling area. There was also a small list of goods under which imports were licensed automatically if the imports took place from specified countries or areas.

On December 17, 1957 Finland established a separate automatic licensing list for the dollar area and for most of the European countries with which Finland had concluded bilateral agreements, provided that the agreement operated normally. On April 6, 1958 the lists of countries to which these import lists applied, were expanded. At the same time more goods were added to the commodity lists.

Circular letters of the Bank of Finland describing the changes undertaken in the payment arrangements during the latter half of 1958 have been appended (appendix 3). Appendix 4 gives a detailed description of the restrictive system as it stood after external convertibility had been attained and of the developments in it during the preceeding years, when preparations were being made.

6 Some longer term consequences

As has been pointed out in the text, the external convertibility decision was not a single decision but rather a prerequisite for our action as to the integration schemes that we were likely to face in the future. The actions of other Western European countries constrained and to some degree steered Finland´s actions. The liberalization of imports since 1957 and the actions with regard to economic integration since then reflected the conviction of the Finnish authorities that the country's economic future lies in trade expansion, not in import substitution. It was this recognition that also necessitated the move towards convertibility.

For ensuring the continued growth of the economy and releaving the strain imposed on the financial structure by large transfers of income to the primary sector, the only way open to Finland was the development of more diversified manufactures exports. The return to industrial protection and exchange restrictions would at no stage have been a feasible option, as the possibilities of industrialization through import substitution would have been exhausted in a very short period due to the small size of the Finnish domestic market.

Thus trend towards the increased openness of the economy implied challenges as to the functioning of the price mechanism and pressures in the context of financing the expansion of the capacity in the open sector. These two challenges the economy had to face are dealt with below.

When Finland abolished the multiple currency practices external and internal price levels became more explicitly dependent on each other. As there were no premiums or discounts applied when receiving or surrendering foreign exchange and as foreign trade was in general free[1], the relative inflationary tendencies in Finland and in other economies (together with productivity differentials) dictated the competitiveness of the Finnish economy in a fixed exchange rate regime. Economic policy was to some degree dependent on the availability of foreign capital, which was also necessary for the diversification of the economy. Another factor that constrained economic policy was whether consensus could be reached on wage agreements between employer and employee organisations, or more generally whether counter-cyclical policies would be successful. Some

1) There were and still are residual restrictions in foreign trade in the field of certain agricultural products and solid fuels, crude oil, and refined oil products. The energy imports are settled, however, by using world market prices and, on the other hand, all countries safeguard their agriculture because of security reasons. Generally these restrictions do not substantially distort the information given by the price mechanism.

policies have seemed to be succesful (e.g. the devaluations of 1957 and 1967) in the medium term, but later problems have emerged making further actions necessary.

Generally it can be said that exports and imports have contributed to establishing price relationships conducive to increased efficiency. From the point of view of the management of the economy the functioning of the price mechanism has made it feasible to acquire relevant information concerning alternative uses of domestic factors of production.

The requirement of increased efficiency also necessitated the expansion of the open sector. This has been accompanied by increased foreign indebtedness Recourse to foreign borrowing to supplement domestic financing is an effective way of promoting the development of a country like Finland. To a great extent this is the manner in which growth has been financed in the past and still continues to be. Oppotunities for profitable expansion of competitive production have arisen mainly in periods of briskly expanding world trade, whereas in periods of slackness the demand for funds does not necessarily exceed the domestic supply of funds.

The fact that smaller developed countries must sell a large proportion of their output in competitive world markets means that their investment needs are pressing, since they have to keep abreast of technological development and adopt without delay the most advanced techniques and equipment. It also means that in periods when world economic expansion increases the investment opportunities for these countries, sharp increase in investment is required.

It was believed in Finland that by opening up the economy and increasing efficiency the rate of investment would be higher than in large industrialized countries or in Finland in the alternative situation in which the economy would have continuously been sheltered from foreign competition by restrictions, controls and high tariffs. Foreign borrowing made it possible to achieve a higher rate of investment; it was also assumed that it was possible to borrow in a self-liquidating way.

In a small economy where the share of foreign trade amounts to between a quarter and a third of GDP the financing of an increase in the rate of investment through domestic credit expansion would within a relatively short period lead to a sharp increase of the current account deficit. This is because the new higher level of national expenditure almost immediately increases the demand for imports, while the benefits, which the additional investments yield in the foreign transactions of the economy, are not felt until three, four or even five years later.

An economy, which in a sense is a marginal producer for the world markets, is bound to have a relatively large variation in exports and GDP. In the Finnish case the structure of trade increases the fluctuations in the economy. Imports consist mainly (to a degree of 60-70 per cent) of raw material, the prices of which are by their nature volatile. Finland´s export structure is also very sensitive to changes in foreign demand. It is interesting to note that as well the average growth of GDP as its variability have been higher in Finland than in Norway, Denmark or Sweden. The fact that the average growth rate of Finland´s exports has not surpassed those of the other Nordic countries, whereas the variability of exports has been significantly greater, has implied a great challenge to stabilization policies.

In the transformation of the economy after the mid-1950´s the greater liquidity of world´s capital markets also increased Finland´s access to foreign capital. Without this the possibilities of economic management would have been seriously constrained. Since imports were liberalized, demand for imports has tended to rise more sharply in Finland than in other countries during periods of expansion. Had sufficient foreign financing not been available, investment and the growth of production would have slowed down.

Convertibility and import liberalization had implications for the role of the central bank. The delicate task of maintaining external equilibrium while at the same time fully utilizing the growth potential of the economy caused a shift in the use of the instruments of central bank policy.

The abolition of detailed regulation (i.e. import licensing and subsidies carried out in various ways) was parallell by adoption of general measures and granting subsidies through various devices was not employed on an important scale. Since imports were liberalized, external equilibrium had to be maintained by demand management. The very direct quantitative procedures that had had a significant role in the central bank policy were to great extent replaced by general monetary policy measures. The coordinated use of monetary and fiscal policies needed even more emphasis than before.

FINNISH INTEGRATION POLICY UP TO THE MID-1960s

The Finnish Government announced officially in connection with the Saltsjöbaden negotiations in 1959 that Finland was interested in establishing collaboration with the European Free Trade Association then in the making. The Scandinavian countries had previously announced that they were no longer interested in the establishment of a Nordic Customs Union. The only alternative remaining for Finland was to join EFTA if she wanted to safeguard her commercial interests.

The FINNEFTA-association agreement was approved on March 27, 1961 and entered in force on July 1 of the same year. As Finland normally had a surplus in trade with the EFTA-coutries, these countries were interested in Finland joining the tariff arrangements of the area. The Finnish position in the negotiations was based on the following points:

1) The establishment of relations in one form or another with EFTA should not lead to the creation of any supranational body that would restrict Finland´s right to self-determination.

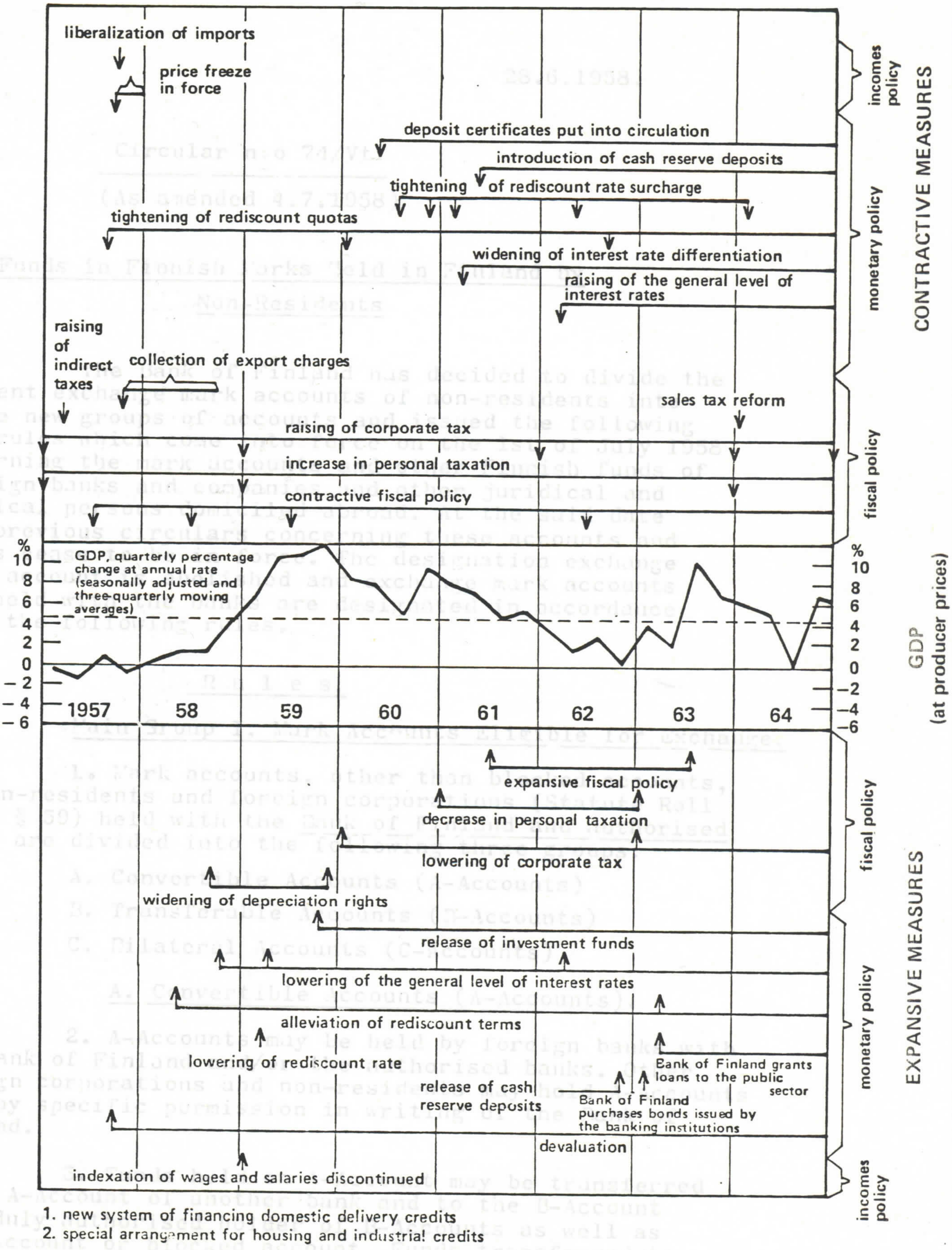
2) Finland had to aim at an agreement that would take sufficientheed ot the special economic circumstances of the country and that would ensure a sufficiently long period of adjustment.

3) The agreement should be of such a nature as to enable Finland to fullfil and to honour all previously concluded commercial treaties.

These preconditions were achieved. A fundamental concession made by the EFTA countries was that Finland was able to maintain quantitative import restrictions on some articles crucial in her trade with the Soviet Union. These articles for two thirds of our imports from the Soviet Union, while the Soviet Union´s share in Finland´s total imports of these articles was four-fifths.

Finland had also to come to an understanding with the Soviet Union which satisfied the EFTA countries and which was within the wider framework of the GATT as regards the question of the most-favoured-nation clause contained in the trade pact with the Soviet Union in 1947. Finland never questioned the validity of the clause. Finland negotiated a new customs treaty with the Soviet Union which signed on November 24, 1960. By the agreement the Soviet Union obtained the same customs benefits that Finland granted to the EFTA countries.

STABILIZATION POLICY MEASURES 1957–1964, A SCHEMATIC DIAGRAM



1. new system of financing domestic delivery credits
2. special arrangement for housing and industrial credits

CIRCULAR LETTERS NUMBER 74/Vt. AND 76/Vt.

28.6.1958.

Circular n:o 74/Vt.
(As amended 4.7.1958)

Funds in Finnish Marks Held in Finland by Non-Residents

The Bank of Finland has decided to divide the present exchange mark accounts of non-residents into three new groups of accounts and issued the following new rules which come into force on the 1st of July 1958 governing the mark accounts and other Finnish funds of foreign banks and companies and other juridical and physical persons domiciled abroad. At the said date all previous circulars concerning these accounts and funds cease to be in force. The designation exchange mark account is abolished and exchange mark accounts now held with the banks are designated in accordance with the following rules.

R u l e s.

Main Group I. Mark Accounts Eligible for Exchange.

1. Mark accounts, other than blocked accounts, of non-residents and foreign corporations (Statute Roll 16/53 § 59) held with the Bank of Finland and authorised banks are divided into the following three groups:

A. Convertible Accounts (A-Accounts)

B. Transferable Accounts (B-Accounts)

C. Bilateral Accounts (C-Accounts)

A. Convertible Accounts (A-Accounts).

2. A-Accounts may be held by foreign banks with the Bank of Finland and/or the authorised banks. Other foreign corporations and non-residents may hold A-Accounts only by specific permission in writing of the Bank of Finland.

3. Funds held on A-Account may be transferred to an A-Account of another bank and to the B-Account of a duly authorised holder of B-Accounts as well as to C-Account or blocked account. Funds transferred to B-, C- or blocked account acquire the nature of the respective account group and cannot be retransferred

4. A-Accounts can be fed either by the sale of US dollars, Canadian dollars and free Swiss francs to an authorised bank or by transfer from another A-Account according to Sec. 3 as well as, by permission of the Bank of Finland, with the countervalue in marks of freely convertible currencies other than the aforementioned.

Credit entries of payments from Finland require specific permission of the Bank of Finland, unless there are provisions to the contrary.

5. Holders of A-Accounts are authorised to convert funds on their accounts into the currency of their own or of other countries and to use them for all such payments in Finland for which the foreign exchange regulations do not require permission to be given in advance by the Bank of Finland.

6. Of the present exchange mark accounts only such accounts of foreign banks on which the funds have already been convertible into US dollars, Canadian dollars or free Swiss francs are automatically designated A-Accounts. The designation of other exchange mark accounts as A-Accounts is subject to authorisation by the Bank of Finland.

B. Transferable Accounts (B-Accounts).

7. B-Accounts may be held with the Bank of Finland and/or the authorised banks by foreign banks, insurance companies, shipowners and aviation companies with their head offices in any of the following countries: the United Kingdom and the Scheduled Territories, Western Germany, Sweden, Norway, Denmark, Holland, Belgium, Luxembourg, Switzerland, Austria, Italy, Portugal and Argentina. In other cases the holding of B-Account is subject to written permission of the Bank of Finland.

8. Funds held on B-Account may be transferred to another B-Account and to the C-Account of a holder residing outside the United States and Canada and to blocked account. Transfer to A-Account is not allowed. Retransfers from C-Account or blocked account to B-Account and from blocked account to C-Account are not allowed.

9. B-Accounts can be fed either by the sale to an authorised bank of currencies mentioned above in Sec. 4 and of currencies of group B enumerated below or by transfers from A-Account or another B-Account.

Group B comprises the following agreement currencies: transferable sterling, Western German Beko marks, transferable Swedish and Danish crowns, Norwegian crowns, transferable Dutch guilders and Belgian francs, Swiss clearing francs, Austrian schillings, multilateral Italian lire and Portuguese escudos.

10. The account-holder may convert funds on his account both into the currency of his own country and into the other currencies mentioned in Sec. 9 but not into freely convertible currency. Funds on B-Account may be used in settlement of such liabilities payable to Finland and originating in any of the countries of group B as do not require settlement in freely convertible currencies or, under the exchange regulations, permission in advance by the Bank of Finland.

C. Bilateral Accounts (C-Accounts).

11. Mark accounts which are held by non-residents, juridical and physical, with the Bank of Finland or the authorised banks and which are not A-or B-Accounts in accordance with the above stipulations or booked as blocked accounts, are designated C-Accounts.

12. Intertransfers on C-Accounts are allowed only between accounts with holders resident in the same country. If banks of the same country may hold B-Accounts, the funds on C-Account are transferable to the B-Account of such a bank. If the holder of C-Account is domiciled in the United States or Canada, the funds on the C-Account are transferable to the A-Account of a bank of the same country. No other transfers to A-or B-Account are allowed.

13. C-Accounts other than those of residents in the United States and Canada can be fed either by the sale to an authorised bank of currencies mentioned above in Secs. 4 and 9 or by transfers from A-and B-Accounts. C-Accounts of holders resident in the United States and Canada can be fed only by the sale to an authorised bank of currencies mentioned in Sec. 4, or by transfers from A-Accounts. Other entries to the credit of C-Account require permission by the Bank of Finland, unless there are other particular provisions.

14. The holder of C-Account residing in the United States, in Canada or in a country provided by Sec. 7 or in another country with which Finland has concluded a payments agreement, may sell funds on his account to the authorised bank keeping the account against the exchange of the country of account-holder or the exchange provided by the payment agreement between Finland and that country. All other conversion of funds on C-Account into foreign currency may be effected only by permission of the Bank of Finland.

15. In cases other than those mentioned in Secs. 12 and 14, the authorised bank may debit C-Account in settlement of liabilities originating in the account-holders country, payable to Finland in the currency of that country and for which the approval of the Bank of Finland, according to the foreign exchange regulations, is not needed in advance.

16. If there are any special stipulations of the Bank of Finland relating to the C-Account, they must be observed irrespective of the above rules.

General Rules

17. If the holder of B-or C-Account has left the country, which has been indicated as his land of domicile, his account conserves its earlier nature with its transfer and other restrictions, unless otherwise decided by the Bank of Finland on application.

18. Interest may be credited to A-, B-and C-Accounts as follows: to sight accounts not more than the rate of interest paid to inland cheque accounts; to accounts of a deposit account character not more than the rate of interest on term deposit accounts paid by the banks. Mark accounts kept for non-residents under this circular cannot be index-tied. Any rate of interest differing from the above rates may be applied only by permission of the Bank of Finland.

19. A-, B-and C-Accounts may be kept within the limits of the above instructions with the Bank of Finland and the following authorised banks: Kansallis-Osake-Pankki, Oy Pohjoismaiden Yhdyspankki (Ab Nordiska Föreningsbanken), Helsingin Osakepankki (Helsingfors Aktiebank), Suomen Maatalous-Osake-Pankki, Säästöpankkien Keskus-Osake-Pankki, Ålands Aktiebank, Oy Wilh. Bensow Ab and Osuuskassojen Keskus Oy.

20. All amounts credited or debited to the account (including transfers) have to be declared by the authorised bank by using the declaration form for the sale and purchase of foreign exchange. The group of account and reason of the transaction must be clearly stated.

Main Group II. Blocked Funds.

General Rules

21. The following funds of non-residents and foreign corporations (Statute Roll 16/53 § 59) are considered blocked funds:

a) All mark accounts with the Bank of Finland, authorised banks, savings banks and co-operative credit societies, except the afore-mentioned A-, B-and C-Accounts,

b) Such book and other claims outside of banks due by persons and corporations in Finland which are not to be settled in foreign clearing currency by virtue of an importation duly accepted, an import licence, a contract, promissory note or other liability. (the nature of blocked funds as such is not affected by the fact that they are expressed or booked either in Finnish marks or in a foreign currency),

c) All investments and other property in Finland as well as compensation received from their realisation, and

d) income from blocked funds of different kinds.,

22. The accounts with the Bank of Finland, authorised banks, savings banks and co-operative credit societies, which, according to the preceding section, are to be considered blocked funds, are called Blocked Accounts, and the respective account sheets must be marked accordingly.

Payments to Blocked Accounts

23. Payments to the blocked accounts must be approved by the Bank of Finland. However, the authorised banks, savings banks and co-operative credit societies are authorised to credit the account with interest accrued thereon and income of other blocked funds administered by the bank as well as with proceeds from the sale of such funds. Without approval of the Bank of Finland the rate of interest credited is not allowed to exceed the rate on deposit accounts paid by the banks.

Use of Blocked Funds

24. Without specific approval of the Bank of Finland, holders may use up to 100.000 marks per person monthly of their funds on blocked account to cover their own travelling and living expenses in Finland or those of members of their families or, in case of the holder being a firm, of members of its staff travelling at its expenses. If the stay in the country lasts more than 3 months, the use of blocked funds must be applied for with the Bank of Finland. Funds drawn by a traveller from a blocked account during his stay in Finland may also be used for purchase of the return ticket from Finland abroad.

25. The administrator (also other than a bank) of a property located in Finland is authorised to use the blocked funds administered by him for payment of necessary expenses incurred by the administration of said property. Any other disposal, realisation and reinvestment of said funds outside of the banks referred to require specific approval of the Bank of Finland.

26. Blocked funds administered by an authorised bank, savings bank or co-operative credit society and income accrued thereon may, if such income according to the special stipulation is not transferable abroad, be invested by the respective credit institution in bonds expressed in marks, including bonds tied to the index (but not in bonds expressed in or tied to a foreign currency). This concerns also funds received with a view of reinvestment or by realisation of blocked funds otherwise effected.

27. Blocked funds cannot be transferred to A-, B- or C-Accounts. The transfer to another blocked account of funds standing on a blocked account as well as transfer to another person or for account of another person of other blocked funds administered by a credit institution mentioned in Sec. 21 a) or deposited with them may be effected by the credit institution only if the transfer is made to a blocked account of a bank situated in the country of the account-holder or owner of the property, or to the name and for account of such bank, whereas the property will remain subject to the regulations governing the blocked funds.

28. In all cases other than those mentioned above, the disposal, investment or transfer of blocked funds are subject to a written permission of the Bank of Finland.

29. Any changes concerning payments from or to blocked accounts or their use as well as changes in other blocked funds administered by or deposited with the credit institutions mentioned in Sec. 21 a) have to be declared to the Bank of Finland by using the proper form. In other cases the prescribed declaration must be made by letter.

Helsinki, 28th June, 1958.

SUOMEN PANKKI-FINLANDS BANK

Circular Letter No. 76/Vt.

Addition to Circular No. 74/Vt concerning funds in Finnish marks held in Finland by non-residents.

The Bank of Finland has decided that, as from today, transfers of funds on B-accounts are permitted not only to other B-accounts, C-accounts, or blocked accounts, but also to A-accounts. Within the frame of the prevailing exchange control regulations, funds on B-accounts may also be exchanged for freely convertible currency and used for the effecting of payments in Finland requiring such convertible currency.

Helsinki, this 29th day of December 1958

SUOMEN PANKKI - FINLANDS BANK

Klaus Waris Reino Rossi