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FINLAND

Recent Economic Developments

Prepared by B.V. Christensen, W.L. Hemphill, and
K.W. Riechel (EUR)

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Basic Data 1/

Area and population

Total area	337,000 square kilometers
Total population (June 1981)	4,798,000
GDP per capita (1980)	\$10,400

	1980	1978	1979	1980	1981
	In billions of Finnish markkaa	Annual volume changes in per cent			
<u>Demand and supply</u>					
Private consumption	101.9	2.6	5.6	2.5	1.0
Public consumption	34.5	3.8	3.7	4.1	3.5
Gross fixed investment	45.8	-8.7	3.8	9.6	4.0
Construction	28.4	-3.3	-0.9	5.9	1.5
Machinery and equipment	17.4	-18.2	13.4	16.5	9.0
Stockbuilding 2/	5.4	-0.9	4.1	1.0	-2.5
Total domestic demand	187.6	-1.1	9.4	5.6	--
Exports of goods and services	63.8	8.1	9.2	9.4	2.0
Imports of goods and services	65.3	-3.1	16.1	11.9	-4.5
Foreign balance 2/	-1.5	3.3	-1.2	-0.3	2.0
GDP	186.1	2.3	7.6	5.0	2.0
Value added in manufacturing	47.9	4.1	11.0	8.1	2.4

Annual averages

<u>Employment and unemployment</u>				
Employment (in thousands)	2,084	2,134	2,203	2,235
Unemployment (in thousands)	169	139	112	119
Unemployment rate (in per cent)	7.5	6.1	4.8	5.1
Participation rate (in per cent)	63.0	63.3	64.2	64.9

Annual changes in per cent

<u>Prices and incomes</u>				
GDP deflator	7.7	7.6	9.4	11.0
Consumer price index	7.8	7.5	11.6	12.0
Export unit values	6.2	12.4	11.5	10.0
Import unit values	10.9	15.6	16.8	13.0
Terms of trade	-4.2	-2.8	-4.5	-2.7
Unit labor costs	2.5	6.5	11.1	11.0
Wages and salaries (index)	6.7	11.5	11.9	12.5
Real disposable household income	4.1	5.2	2.7	--
Savings rate 3/	7.3	6.9	7.1	6.0

1/ Changes are based on annual averages. Figures for 1981 are official estimates.

2/ Change as per cent of previous year's GDP. The stockbuilding figure includes the statistical discrepancy.

3/ Household savings as a per cent of disposable income.

	1978	1979	1980	1981 1/
<u>Government finances 2/</u>	<u>In per cent of GDP</u>			
General government				
Revenue	39.5	38.0	37.9	39.0
Expenditures	39.0	38.3	38.0	38.5
Budget balance	0.5	-0.3	-0.1	0.5
Central Government				
Revenue	24.7	23.6	23.7	24.6
Expenditures	26.4	26.4	25.9	26.3
Budget balance	-1.8	-2.9	-2.2	-1.7
Effects of fiscal stance of general government 3/				
High employment balance	3.0	1 1/4	1.0	1 3/4
Weighted budget balance	...	1.1	0.2	--
	<u>Annual averages</u> <u>Changes in per cent</u>			
<u>Monetary data</u>				
Narrow money (M1)	11.3	16.5	11.0	7.6
Broad money (M3)	14.6	15.9	16.0	14.0
Credit to the private sector	10.7	13.5	19.4	15.7
	<u>In per cent</u>			
Discount rate	7.6	7.5	9.2	9.3
Official call money market rate	12.0	9.7	12.4	11.5
Average cost of bank borrowing from central bank	8.9	9.0	12.4	11.5
Average bank lending rate	8.2	8.0	9.8	9.8
	<u>In billions of Finnish markkaa</u>			
<u>Balance of payments</u>				
Merchandise exports (f.o.b.)	35.2	43.4	52.8	59.7
Merchandise imports (c.i.f.)	32.3	44.2	58.3	62.7
Services and transfers	-0.3	--	0.3	-0.1
Current account	2.6	-0.8	-5.2	-3.1
Long-term capital	3.7	0.9	0.2	3.5
Short-term capital	-3.1	0.5	5.5	1.8
Errors and omissions	0.9	-0.1	0.6	0.2
Monetary movements, Bank of Finland 4/	4.2	0.6	1.1	2.4

1/ Data for monetary aggregates give growth rates for the first half of 1981 over the first half of 1980. Data on interest rates give averages for the period January-October.

2/ General government data are on a national accounts basis; expenditures cover current outlays and gross investment. Central Government data are on a cash flow basis.

3/ The "high employment balance" is a cyclically adjusted measure of the general government budgetary surplus, expressed as a percentage of cyclically adjusted GDP. A decline signifies an increase in stimulus. By contrast, the "weighted budget balance" is an estimate of the contribution of actual general government transactions to real GDP growth in the same period, with a positive figure signifying stimulus.

4/ A positive figure indicates an increase in net reserves.

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u> <u>1/</u>
Current account balance (in billions of U.S. dollars)	0.6	-0.2	-1.4	-0.7
Current account balance (in per cent of GDP)	1.9	-0.5	-2.8	-1.5
Total net foreign debt (at end of period in per cent of GDP)	18.2	15.2	15.7	16.0

In millions of SDRs; end of period

Official reserves

Gold <u>2/</u>	33.3	34.7	34.7	34.7
SDRs	61.8	88.1	81.3	138.5
Reserve position in the Fund	46.1	44.6	77.5	77.9
Foreign exchange	<u>830.8</u>	<u>1,036.3</u>	<u>1,307.6</u>	<u>1,104.7</u>
Total	972.0	1,203.7	1,501.1	1,355.8

Changes in per cent; period averages

Exchange rates and international competitiveness

U.S. dollar per markkaa	-2.1	5.7	4.4	-13.7
Effective rate				
Bank of Finland	-9.5	-0.1	3.3	0.5
MERM	-9.5	3.1	4.5	-4.2
"Real effective exchange rate" <u>3/</u>	-14.6	-1.8	-1.1	3.9

1/ Net foreign debt as of end-June and reserves as of end-September 1981. Exchange rates are average January to November 1981, compared to same period in 1980.

2/ Gold valued at SDR 35 per fine troy ounce.

3/ Bank of Finland index of relative unit labor costs in common currency.

I. Developments in the Domestic Economy

1. Background

The international recession of the mid-1970s, and the domestic stabilization policies that were followed, resulted in an annual rate of GDP growth in Finland of about 1/2 per cent in each of the years 1975-77 (Chart 1). The volume of exports fell in 1975, and domestic demand declined in 1976. Concurrently with the export decline, both the inflation rate and the deficit on the current account of the balance of payments increased very sharply. The stance of financial policies was tightened markedly in 1976. In addition, the markka was depreciated by 16 per cent in effective terms during 1977 and early 1978, and a sequence of general incomes agreements was achieved that tended to reduce the ongoing inflationary momentum. Both the balance of payments and the inflation rate responded significantly to these strong stabilization measures. The current account deficit fell, in response to the drop in domestic demand but also to the improved competitive position, from 8 per cent of GDP in 1975 to one half per cent in 1977, and was in surplus in 1978. Export growth had rebounded in 1976 and was maintained at 8-9 per cent a year in the subsequent two years, while the volume of imports declined steadily. The rate of inflation, as measured by the annual change in the consumer price index, slowed from 18 per per cent in 1975 to 8 per cent in 1978.

Not unrelated to these successes, the weakness of domestic demand was unusually prolonged. Besides the restrictive impact of financial policies--which, in fact, were relaxed as progress on inflation and the external imbalance continued--the economy was confronted by substantial excess productive capacity and unneeded inventories. For three years, starting in 1976, inventories and fixed investment declined markedly. Over the same period, the level of real private consumption rose only slightly above its 1975 level. Thus, weak domestic demand outweighed the continuing strong growth of exports, and unemployment increased steadily from its former historical norm of 2 per cent, last achieved for 1975, to 7 1/2 per cent in 1978.

Real disposable income began to revive in 1978. While incomes before tax increased only 4 1/2 per cent in nominal terms for the year as a whole, reductions in tax rates (which were large because of the high inflation rate of the preceding year) and a change in the timing of income tax refunds resulted in a 12 per cent increase in disposable income, about 3 1/2 per cent in real terms. With income increasing and the volume of exports continuing to grow at about 9 per cent, by the last quarter of 1978 activity had begun to pick up noticeably in key industries and, by early 1979, production in all the important manufacturing sectors was rising. The wage bill increased by 14 1/2 per cent during 1979, and real disposable income by 5 per cent, giving rise to an acceleration of private consumption growth to 5 1/2 per cent in real terms despite the fall in the terms of trade attendant on the new round of oil price increases. The decline in gross fixed investment in real terms was arrested, a 4 per cent increase being recorded for the year. Inventories were rebuilt from very low levels, contributing 4 percentage points to the growth of total demand. For 1979 as a whole, the rate of growth of real GDP--7 1/2 per cent--exceeded that in any of the other industrial countries.

During 1980 and 1981 GDP growth decelerated rapidly, as had been widely expected. Nevertheless, Finnish economic performance has been strong by international comparison. At 5 per cent in 1980, growth again exceeded that of all of the other industrial countries, and in 1981 it is likely to amount to 1-2 per cent and thus to remain above that of the larger European economies. This favorable outcome, especially so through the earlier part of the global downturn, is attributable in part to the strong growth of exports to the U.S.S.R. in 1980 and 1981 (Chapter IV).

There is an element of uncertainty regarding the 1981 growth rate in light of the preliminary national accounts figures for the first two quarters. The official estimate of 2 per cent for the year (Table 1), prepared early in the fall, is based on the high level of output attained at the beginning of the year and does not assume any further intra-year growth; indeed, it allows for a slight decline in the pace of activity. Nevertheless, the actual change in GDP in the first half-year, according to data currently available, was -3 1/2 per cent (seasonally adjusted at an annual rate), a drop sharp enough to make the official estimate for the year appear optimistic. Two considerations support the higher estimate, however. One is that the revised system of national accounts has been fully implemented only since 1979, and thus far the preliminary GDP figures for the first two quarters have understated the final version by 1-1 1/2 per cent (2-3 per cent in terms of annual growth rates). The other factor is that a number of comprehensive indicators showed more strength than the GDP estimates in the first half of 1981. The relevant data are presented in the tabulation below (based on seasonally adjusted series published in the Bulletin of Statistics). Export growth increased, for example, and the volume of retail sales decreased only slightly. Industrial production in Finland, on the other hand, was somewhat weak even allowing for its volatility.

	Percentage change on preceding half-year, seasonally adjusted at annual rates		
	1980 1st half	1980 2nd half	1981 1st half
GDP	4.5	7.6	-3.6
Private fixed investment	12.0	12.7	-13.9
Merchandise exports	15.7	5.0	8.5
Volume of retail sales	1.1	3.1	-0.5
Industrial production	1.1	13.0	-5.0
GDP percentage change from corre- sponding period of preceding year	4.2	6.0	1.8

2. Domestic demand

Despite a prospective weakening in foreign markets, final domestic demand continued to grow quite strongly in real terms in 1980, by 4 1/2 per cent compared with 5 per cent during the boom year of 1979 (Table 1 and Chart 2). The 1980 pace was primarily attributable, however, to private fixed investment, which increased by 11 per cent after adjusting for inflation. In 1981, the growth of domestic demand has decelerated. In the official estimates for the year as a whole, the 2 per cent growth of demand for final consumption and investment goods is fully offset by the decline in inventory accumulation, and total domestic demand shows no change in volume terms over 1980.

a. Consumption

Private consumption ^{1/} in recent years has accounted for about three quarters of total consumption and for one half of GDP. After expanding rapidly in 1979 (Table 1), probably aided by the lump-sum tax reimbursements made late in the preceding year, consumption expenditure in real terms increased by 2 1/2 per cent in 1980 and is officially estimated to grow by 1 per cent in 1981. In general, these changes have been very much in line with movements in real disposable income (Table 2), which has increased significantly less than GDP in recent years. In 1980 and 1981, the slower growth of income is attributable in part to tax changes: the inflation adjustments to income tax rates are lagged one year, and fiscal drag occurs when inflation accelerates, as in 1980; because the last of the "late" income tax reimbursements was made in 1980, net taxes increased in 1981. (These technical developments relating to taxation are explained in Chapter II.) Also holding back real income in these years, relative to output, were the adverse terms of trade changes. Consumer prices rose 1-2 per cent faster than the GDP deflator. As a result, nominal income gains, although in line with the growth of GDP, were insufficient to cover a proportional increase in consumer purchases. In fact, the tax change in 1981 is itself sufficient to reduce growth in real disposable income by 1 1/2 percentage points. It is expected that this drop will be partly offset by a decline of 1 percentage point in the savings ratio in that year, from 5 per cent in 1980 to 4 per cent (Table 2), much the same as occurred in the preceding downturn. ^{2/}

Consumption of durables has followed the usual cyclical pattern during recent years. In 1979, volume growth was 15 per cent, nearly three times that of nondurables, and it was 6 1/2 per cent in 1980. In 1981, consumption of durables is expected to decline by 4 per cent. This category accounts for around 10 per cent of private consumption, on average.

The rate of growth of public consumption in real terms has declined steadily from 6 1/2 per cent in 1975 and 5 1/2 per cent in 1976 to around 4 per cent during each of the years 1977-81. This fall in the rate of growth reflects an explicit policy of constraining the proportion of resources

^{1/} Defined to include nonprofit organizations as well as households.

^{2/} For households alone the figures are 7 per cent in 1980 and 6 per cent in 1981.

absorbed by the government sector of the economy and increasing that available to the enterprise sector (see Chapter II). Attainment of this goal was facilitated during the period by the gradual completion of major programs of expansion of primary and secondary education and hospital and health care. Typically, growth of central government consumption has been slower, local government consumption more rapid, than these percentages for overall government consumption, reflecting the carrying out by local authorities of the special employment support programs utilized in recent years. The increase of 1/2 of a percentage point in the growth of public consumption in 1980 (Table 1) is reportedly more than accounted for by an increase in the acquisition of equipment for national defense purposes.

b. Fixed investment

The sharp declines in fixed investment in the years 1976-78, which cumulate to 25 per cent in real terms, were a reflection in part of the major investment boom of the early 1970s--one that carried over into 1975, after other activity had slowed. With the resumption of vigorous economic growth, investment spending also rose sharply, by 18 per cent in real terms during 1979-81 (including the official estimate for 1981). However, there is evidence that this investment rebound will not result in as large an increase in productive capacity, relative to present utilization levels, as occurred in 1975. For example, the share of gross fixed investment (public and private) in GDP in 1981 is estimated provisionally to be 26 per cent, a proportion that appears about average in historical perspective. ^{1/}

For the most part, these sharp swings in investment spending reflect changes in the private component. Capital formation in the government sector fell in 1976, as fiscal policy became restrictive (see Chapter II), but it expanded at modest rates in subsequent years, consistent with the overall fiscal strategy of limiting the growth of government expenditure. For all levels of government added together, investment spending accelerated from a real rate of growth of 1/2 per cent in 1978 to 3 per cent in 1981 (Table 1). In part this reflected a countercyclical postponing of some projects originally included in the 1979 budget, followed by a similar rescheduling in 1980.

Business sector investment (including state enterprises) began to grow strongly in real terms in the second half of 1979, about a year after the start of the upturn in industrial production. The resumption of investment growth is attributable to strong cyclical forces--the elimination of excess capacity and stocks and the improved outlook for both foreign and domestic demand--as well as to a strengthening of profits. Because of the high tax rate on distributed corporate profits, and liberal allowances for depreciation of inventories as well as fixed investment, firms had a special incentive to

^{1/} The average ratio for the years 1960-80 is also 26 per cent. Investment had increased from 22 1/2 per cent of GDP in 1968 to 31 per cent in 1975, the beginning of the preceding recessionary period. Capacity utilization is expected to be about 88 per cent in 1981 (see Section 4a) compared with 81 per cent in 1975.

reinvest their earnings. ^{1/} During 1980, private fixed capital formation expanded by 11 per cent in real terms.

In 1981, the growth of private investment is officially estimated to decelerate to 4 1/2 per cent in real terms, despite the release of some countercyclical deposits toward the end of the year (Chapter II) and the easier stance of monetary policy (Chapter III). Indeed, the preliminary national accounts figures for the first half of the year suggest an even weaker development (see Section 1). Acquisition of equipment is projected to expand more strongly, by 9 per cent, than new construction, 1 1/2 per cent (Table 3). Investment in the paper industry has been sustained by continuing work on several very large long-term projects. Also, investment in some parts of the metal industry has continued to grow rapidly with the persistently strong expansion in demand, mostly from abroad and especially for forest industry machinery and for ships. The energy sector will add capacity at a very high rate in 1981, amounting to real investment growth of 28 per cent. In most other sectors of industry a decline in real investment spending is already under way according to banking sector reports.

Growth in construction is not likely to be strong in 1981, despite the removal of the special tax on nonpriority building in the fall in many communities. In the preceding year, the investment boom was prolonged by construction activity. Growth in this sector had resumed only in 1980, but it was sufficiently strong (7 1/2 per cent in real terms) that shortages of skilled labor were encountered in some localities before the end of that year, stimulating the adoption of the special tax. The pickup caused by the removal of the tax is expected to be small because of its narrow application (to about 12 per cent of total construction), and because of the downturn in overall activity. On the other hand, the sharp drop in the number of permits granted (Chart 3) in early 1981 may well reflect partly the imposition of this tax late in 1980; therefore the outlook for 1981 may be less gloomy than is suggested by the figures for the first quarter.

c. Stockbuilding

Inventories were reduced by increasing amounts over the years 1976-78, constituting a significant offset to domestic demand for final goods. The negative contributions to GDP growth (Table 1) were increased by 1/2-1 percentage point in these years by the inclusion of the statistical discrepancy, but would be noteworthy even without this presentational convention. Under Finnish tax laws there tends to be an incentive to add to stocks in boom years but not in slack years (mentioned in Section 2b). This asymmetry may account for a part of the large fluctuations in the inventory volume.

^{1/} These taxation factors help explain the observed strong correlation between changes in corporate profits and changes in investment expenditure for the enterprise sector as a whole. Capital formation is also encouraged by a number of noncyclical factors, notably including real interest rates held at negative or near zero levels, and a sales tax incentive. A reduction to half of the ordinary sales tax rate of 14 per cent was adopted for manufacturing equipment beginning April 1, 1978; the concession was reduced to one third starting in 1980. New industrial construction has been exempt from the sales tax on buildings (also 14 per cent) since August 1977.

In 1979, the turnaround in stockbuilding alone accounted for 4 percentage points of GDP growth (out of 7 1/2 points in total). Stockbuilding continued to be rapid in 1980, adding 1 percentage point to aggregate demand growth. With the downturn in 1981, inventories virtually stopped growing; the withdrawal of demand for the purpose of adding to stocks amounted to 2 1/2 per cent of GDP.

3. The foreign balance

The pickup in activity in 1979 was accompanied by rapid growth of imports of goods and services, and, like the underlying pace of activity, this expansion continued into 1980. In volume terms, import growth was 16 per cent in 1979 and 12 per cent in 1980, while export growth remained at 9-9 1/2 per cent in both years. The change in the real foreign balance in these two years thus offset part of the stimulus of higher domestic demand, by about 1 per cent and 1/2 per cent of GDP, respectively (Table 1 and Chart 2).

After five years of very strong growth, the increase in exports of goods and services in 1981 has been modest. The continuing decline in demand in Western markets has been offset by a further expansion of sales to the U.S.S.R. Overall, growth of 2 per cent has been officially estimated, although preliminary figures for the first half of the year (see Section 1) suggest a somewhat faster rate. But imports have declined, in real terms, so that altogether the foreign balance has exerted a positive effect of 2 percentage points on GDP growth. The fall in imports of goods and services is officially estimated to be 4 1/2 per cent in 1981, although it was even sharper in the first half of the year according to seasonally adjusted data for merchandise trade.

4. Output, employment, and productivity

a. Production

The average level of capacity utilization in industry jumped to 85 per cent in 1979, and increased further to 89.5 per cent in 1980, compared with a judgmental "full utilization" level of 90 per cent. By mid-1980 some order backlogs and shortages of skilled labor appeared in the metals industry and construction, but by mid-1981 the bottlenecks eased considerably. The prospects for further growth were less buoyant by then. In addition to a considerable softening of foreign demand, several countercyclical measures had been enacted (see Chapter II), and there had also been a slight deterioration of competitiveness. The volume of industrial production had expanded strongly through the third quarter of 1980 (Chart 3), then declined abruptly in the fourth quarter, with no subsequent resumption of substantial growth. According to the June investment inquiry made by the Bank of Finland, the average rate of utilization of industrial capacity was expected to be 87.5 per cent for 1981. Industrial production is projected to increase by 2 1/2 per cent in 1981, after 7 1/2 per cent growth in 1980 and 10 1/2 per cent in 1979.

In instances in which output in individual sectors departed markedly from this general pattern over recent years, production for export markets was typically the primary reason. This was notably the case for forestry and the related wood and paper sectors of manufacturing. 1/ Forestry output increased strongly in 1977, and the wood and paper industries followed in 1978 as European inventories of these products were rebuilt. After extremely rapid growth again in 1979, by 21 per cent in volume terms (Table 4), primary forestry output declined slightly in 1980 following a strike in the spring and is expected to fall by 4 per cent in 1981. Manufactured forest products also expanded very strongly in 1979, by 15 per cent, but unfilled orders declined in the second half of 1980. In the first half of 1981, output of wood products was 11 per cent lower than a year earlier, paper products only 2 per cent higher, reflecting the slackening of export demand in Western markets. The general slump in construction activity abroad will reduce exports of sawn timber by a fifth and also result in sharp cutbacks in exports of plywood and particle board, according to industry sources. In total, output in the forest industries is expected to drop by 4 per cent in 1981.

Annual timber fellings increased about 15 per cent per year in volume from the 1975/76 season through 1978/79. Despite this generally impressive growth rate, current timber production is only about two thirds the volume cut in 1970, and one third that of the mid-1950s, partly because of current silvicultural programs intended to extend timber resources. Thus, the level of cuttings throughout the 1970s has remained below the annual increase in the forest stock. The wood products and paper products branches of manufacturing absorb more than the domestic felling, and additional logs are imported from Sweden and the U.S.S.R.

Another industry significant in exports is metals. 2/ Value added by engineering and metals products expanded by some 11 per cent in volume in 1980, the same rate as in 1979, and is expected to increase by an additional 6 per

1/ Forestry output accounts for about 6 per cent of GDP, the same proportion as the wood and paper products branches of manufacturing (with two thirds from wood pulp and paper and one third from sawn timber). Forest products in total account for about two fifths of merchandise exports. Forests cover about 70 per cent of the total land area of Finland. By comparison, 9 per cent is farmed. A third of the forest land is publicly owned and the remainder is private, divided typically into small holdings of about 100 acres. Many farmers supplement their incomes by "forest farming," and agricultural workers find forestry employment in winter, when most of the cutting, stacking, and measuring is carried out.

2/ The metals industry accounts for 10 per cent of GDP and for 20-25 per cent of merchandise exports. It is subdivided into basic metals (refining) and metal products. Finland is the leading West European producer of copper and nickel, and mines significant amounts of vanadium, chromium, and cobalt. It possesses extensive reserves of low-grade iron ore. Metal products is comprised, in turn, of machinery (including, notably, paper-making machinery, and also forestry equipment), transport equipment (ice-breakers and other specialized ships, and farm implements), electrical engineering, and metal fabrication.

cent in 1981 (compared with 3 per cent for manufacturing other than wood products and metals). This activity is presently sustained by a relatively high level of unfilled orders, both for domestic markets and exports.

Value added in agriculture grew by 5 per cent in 1980, a year of generally favorable weather conditions and good harvests. However, the 1981 growing season was wet and cold, and output is expected to be 1 per cent lower on average than in 1980.

b. Employment

During the period of low output growth from 1975 to 1978, the rate of unemployment increased from 2 per cent to 7 1/2 per cent in terms of yearly averages. Over the same period, there was a marked decline in the labor force participation rate, from 64 1/2 per cent to 63 per cent of the population--or about 2 1/2 per cent of the labor force--and an increase in the net emigration of Finnish workers, amounting to about 1 per cent of the labor force. These changes more than offset the natural increase in the number of workers, and the labor force declined about 1 per cent. ^{1/} Because of these reactions to the reduced number of jobs, the average yearly increase in the unemployment rate of nearly 2 percentage points was, thus, no greater than the fall in employment over the same period.

When output subsequently expanded, the supply of labor increased along with, if by less than, the demand for it. In 1979 and 1980, the unemployment rate fell below 5 per cent, while labor force participation increased 1 percentage point and net migration nearly ceased ^{2/} (Table 5 and Chart 3). As the working-age population grew about 1/2 per cent per year, approximately half of the 3 per cent increase in employment in each of these years was matched by an increase in supply, the balance by a decrease in unemployment. In the second half of 1981, with weakening production, the unemployment rate has begun to increase again, although employment remained at levels higher than a year earlier well into the fall. An average unemployment rate of more than 5 per cent is expected for the year, largely reflecting increased participation, which is expected to add 1 per cent to the labor force for 1981.

There have been no significant changes in specific employment support programs since 1978-79. Immediately following their expansion in those years, the impact of these measures was considerable. Approximately 67,000 jobs were provided in 1979 (not including vocational training), accounting for almost

^{1/} Data for employment and related series are affected by a revision in the labor force survey methods, causing a discontinuity between observations for 1975 and 1976. However, while formerly smaller samples were used, with larger sampling error, there is no reason to believe the population estimates were biased.

^{2/} A net outflow of workers has been occurring for many years, and was much larger in the early 1970s. Relative housing supplies, as well as job vacancies at home and abroad, have been important determinants of the flow. The recent halt undoubtedly reflects the slowdown in employment growth in Sweden as well as improvement in the domestic economic situation.

3 per cent of the labor force and for more than half of the increase in employment over 1978. One program established subsidies to municipalities for providing part-time work to otherwise unemployed persons and to firms for hiring unemployed young people. This program accounted for 31,000 jobs in 1979, 26,000 in 1980. An experimental program of "youth employment guarantees" was instituted in some 30 communities. Along lines suggested by the OECD, the program undertakes to ensure either vocational training or an initial job to all persons entering the labor force out of secondary school. In addition, vocational training was expanded to accommodate some 30,000 persons per year (equal to almost a fifth of the total number unemployed, or 1 1/2 per cent of the labor force). Since 1978, approximately 27,000 persons per year have completed training, which requires on average six months; approximately 12,000 persons are enrolled at present.

Historically there has been a trend decline in employment in agriculture and forestry, predominantly in the northern and western regions of Finland. Cyclical unemployment, however, is more than proportionately concentrated in manufacturing, mining and utilities, located primarily in the south. In addition to these longer-term patterns, recent demographic and social changes have affected the composition of the group of job-seekers. The unemployment rate for persons under 25 years of age has been twice that for the economy as a whole during 1980 and 1981, a value close to its historical average; young people comprised nearly two fifths of those unemployed at the time of the recent unemployment peak in 1978. The great majority of those unemployed in this age group have no vocational training. This condition is being ameliorated by the expansion of vocational programs, mentioned before. In spite of additional skills, however, the unusually large proportion of young workers in the labor force will tend to increase the unemployment rate, since younger workers spend more than the average amount of time seeking employment--finding a first job or trying alternative positions.

A second structural factor affecting unemployment is the increasing labor force participation of women in recent years and the declining participation of men. The latter pattern is observable, over the past five years, only among teenagers and older men (a decline from 65 1/2 per cent to 60 1/2 per cent participation in the 55-59 year age grouping, and from 41 per cent to 35 per cent in the 60-64 year grouping). Two factors known to contribute to this trend in male participation are (i) the greater difficulty of older workers in finding new work after being laid off, especially in a long recession, and (ii) a temporary reduction to age 55 of the minimum at which a person suffering long-term unemployment can retire with pension benefits. ^{1/} To the extent that the decline in male participation is partly cyclical and temporary, while increasing job-holding by females is structural, the effects of the latter are more significant for the rate of unemployment that may be regarded

^{1/} Detailed statistics show that the average duration of unemployment increases steadily from 17 weeks for the 15-19 year age group to 51 weeks for the 50-54 year age group, but falls abruptly to 28-30 weeks for workers aged 55 years and older. This drop reflects the fact that some older workers, after being unemployed for the period required to qualify as "long term," exercised their option to take early retirement and thus leave the labor force.

as corresponding to "full" employment. Formerly this rate was reckoned to be around 2 per cent, but recent estimates suggest it may have increased to between 3 1/2 and 4 per cent in light of changes in the age and sex composition of the labor force.

c. Productivity

Average labor productivity in the economy as a whole increased 3-4 per cent in 1977 and 1978 as, in general, firms reduced employment in line with the continued weakness of economic prospects (Table 6). In 1979, labor productivity jumped by 6 1/2 per cent, reflecting the usual cyclical phenomenon of output increases in excess of employment at the outset of an expansion. Productivity advances slowed to an average of 4 1/2 per cent in 1980 and to 1 1/2 per cent in 1981, as production weakened. Rapid rates of capital formation during 1980 and 1981 have undoubtedly had a positive effect on potential output per man-hour, but the period of slower growth that began in late 1980 will tend to cause a productivity decline as output in some sectors decreases faster than the workforce can be adjusted.

Productivity gains have been high in agriculture when favorable weather supported good crop yields, as in 1980 (3 per cent), and also when employment growth in the nonagricultural economy permitted a timely exit of surplus farmworkers, as in 1979 (a noteworthy 11 per cent). A very modest increase is probable in 1981, due in part to the poor harvest. The productivity growth figures for manufacturing (including mining and utilities) have been typically smaller than those in agriculture and forestry during the 1970s, declining from 6 per cent in 1979 to 4 per cent in 1980 and 1 per cent in 1981. In forestry, productivity is recorded to have increased 9 per cent in 1979, then to have fallen by 1 per cent in 1980. In 1981, productivity gains in forestry are expected to pick up. In the service portion of the economy, accounting for about two fifths of GDP, productivity growth has been more stable, but is expected to dip to 1 per cent in 1981.

5. Incomes and prices

a. Wage developments and labor costs

The rate of increase of wages and salaries decelerated markedly after 1975, against the background of a slowdown in foreign trade prices, weakening domestic demand, and rising unemployment. The average increase in negotiated wage rates was moderated by the introduction of informal indexation of direct taxes, ^{1/} while wage drift was dampened by slack labor market conditions. In real terms, the level of ordinary-time wages and salaries in 1978 was on average 4 1/2 per cent below that attained two years earlier, although real disposable incomes had increased by some 2 1/2 per cent because of tax cuts.

^{1/} While adjustments to tax rates and allowable deductions to offset the effects of inflation had occurred in earlier years, in 1977 the size of the adjustment was expressly linked to the inflation rate. See also Chapter II.

In 1979, the average change in negotiated wage rates shot up from the preceding year's 4 1/2 per cent to 10 per cent, a rate well in excess of the rise in the price level (Table 7). Including wage drift, wages and salaries increased by 3 1/2 per cent in real terms, to a level roughly 1 per cent below that attained in 1975. To a significant extent, the effect of the 1979 increases on costs was offset by favorable productivity gains (Table 6). Unit labor costs increased only 6 per cent (4 1/2 per cent in manufacturing), compared with a 7 1/2 per cent increase in the GDP deflator (Table 7 and Chart 4). A sharp acceleration of unit labor costs to 11 per cent (10 1/2 per cent in manufacturing) occurred in 1980. This increase was partly matched by the acceleration of the GDP deflator, and was substantially accounted for by the end of the cyclical productivity spurt. In real terms the average increase in wages and salaries was close to zero, again implying a level slightly below that reached in 1975. Real disposable income in 1980 rose by 2 1/2 per cent because of the growth of employment in that year and despite the tax rate adjustments for the much lower inflation rate of 1979.

The comprehensive wage and salary agreement negotiated in 1979 was notable for its provision for supplementary increases to be granted if a specified threshold level of the consumer price index was crossed. Explicit wage indexation had been illegal in Finland for some years, and this provision constituted a limited resumption. 1/ As it turned out, the threshold was not exceeded. In the following year no centralized incomes agreement was reached. In 1981 there was, again, a comprehensive agreement. It also contained an indexation clause, this time with the novel provision that an estimate of the effect of the terms of trade movement, positive or negative, was to be excluded in computing the change in the cost of living. Specifically, four nominal income increases were scheduled over a two-year period, amounting to a cumulative increase of 12 per cent, 2/ with an extra 1/2 per cent provided for nonproportional company-level wage adjustments. These scheduled increases would be supplemented, in each of the two years, in the proportion by which the adjusted version of the consumer price index rose more than a specified threshold increase. The change in the CPI was to be adjusted by subtracting one third of the deterioration in the terms of trade or adding one third of the improvement. 3/

1/ In the post-war period, Finnish wages were explicitly indexed in incomes agreements for the years 1945-51, 1964-65, and 1967-68. (Compensations were typically made for discrete 3-5 per cent increases in the cost of living index occurring over specified time periods, so that in some years no adjustment was made.) The stabilization agreements of March 1968 and September 1969 included provisions abolishing the index clause from practically all wage and income agreements, as well as financial contracts. In 1979, and again in 1981, the Act making indexation generally illegal was modified to permit the limited forms of adjustment mentioned.

2/ The four scheduled increases are 3.8 per cent on March 1, 1981; 2.6 per cent on September 1, 1981; 2.2 per cent on March 1, 1982; and 3 per cent on September 1, 1982. Special allowance is made for larger increases for low-income earners.

3/ The fraction, one third, corresponds roughly to the degree of openness of the economy, imports of goods and services as a fraction of GDP, rather than to the narrower concept of the import component of the average consumer market basket. Three-month moving averages are used in computing the change in the terms of trade.

The thresholds do not differ very much from the agreed nominal wage increases, and adjusted CPI increases in excess of these percentages are likely; thus, the de facto agreed nominal wage increases correspond approximately to a zero real increase over the two years, apart from wage drift and from the change in the terms of trade. Based on the changes specified in the agreement and estimates of wage drift, an average increase of 12 1/2 per cent in wages and salaries is expected for 1981, about 1/2 per cent in real terms. In light of the very small expected rise in average labor productivity, unit labor costs are likely to rise again by 11 per cent (10 per cent in manufacturing).

b. Nonwage income

Entrepreneurial income increased after the initial years of the last recession; the share of labor costs in national income fell from 68 per cent in 1977 to 65-66 per cent in subsequent years (Table 2). Retained corporate earnings doubled in 1978, from a low base, and nearly doubled again in 1979. In 1980 they expanded by 10 per cent, and are expected to increase about that much in 1981 as well. Household entrepreneurial income from agriculture is likely to grow by 12 per cent in 1981, a rate linked to the wage and salary increases specified in the comprehensive income agreement. Income from forestry is expected to grow by 5 per cent in nominal terms as output in that sector declines, while other household entrepreneurial income will also fall in real terms, by 2-3 per cent.

c. Prices

During the protracted period of weak domestic demand, the rate of inflation decelerated steadily. The rate of increase of the consumer price index fell by more than half, from 18 per cent in 1975 to 7 1/2 per cent in 1978, while the GDP deflator slowed from 15 per cent to 7 1/2 per cent. Over this same period, the annual change in a weighted average of the GDP deflators of all of the industrial countries was constant at 7 1/2 per cent. The deceleration in Finland was achieved despite an effective depreciation of the markka by 16 per cent during 1977 and 1978.

During 1979, the rate of increase of consumer prices edged up from 7 per cent in the first quarter (year-on-year) to 8 per cent in the final quarter. The rise in import prices over that period (17 per cent) was moderated by a 3 per cent effective appreciation of the markka, and the normal lag between increases in the prices of crude petroleum and of final products pushed part of the oil-price effects into 1980. The slow acceleration of prices during 1979 was followed by a rapid acceleration in 1980. The year-on-year rate of change in the CPI increased 5 1/2 percentage points, reaching a rate of 13 1/2 per cent in the fourth quarter, then slowing somewhat to 11 1/2 per cent by the fourth quarter of 1981. The average increase in the CPI was 11 1/2 per cent in 1980 and, provisionally, 12 per cent in 1981 (Table 7). The GDP deflator accelerated less than the CPI during 1980, increasing by 9 1/2 per cent on average for the year. It appears likely that the change in the GDP deflator will increase further to 11 per cent in 1981, slightly less than the expected rise in the consumer price index.

II. Fiscal Policy

1. Background

In 1974 and 1975, a stimulative fiscal policy was adopted in Finland in response to the expectation of worldwide recession. As it turned out, the expansionary influences present in the economy proved to be surprisingly durable. By the end of 1975, as a result of the oil-price increases and the support of domestic policies designed to avert a sharp decline in output, both the inflation rate and the deficit on the current account of the balance of payments had become disturbingly large. Consequently, the thrust of financial policies was sharply reversed for 1976. Concurrently, however, the strong deflationary effects of the course of global aggregate demand and prices also affected the Finnish economy. These external events, together with the restrictive domestic policies, contributed to a marked strengthening of the external balance but also to the onset of domestic recession. A large increase in unemployment followed, while price and wage inflation continued at high rates. The urgent need to find a means of dealing with substantial inflation and unemployment simultaneously was reflected in the fiscal program that was then devised. Part of it had first appeared at the time of the tightening of policy in 1976, but the new measures were identified primarily with the medium-term stabilization strategy announced in the middle of 1977.

The overall aim was that of promoting an increase in the output of the enterprise sector--while restraining the share of the government sector--by fostering competitiveness, in order to increase employment from the supply side. To minimize cost increases, producers were given tax concessions on purchases of investment goods. Social insurance contributions were decreased somewhat for both employers and employees. An arrangement for informal indexation of income taxes was implemented in 1977, in return for which the employees' organizations consented to smaller nominal wage and salary increases. A series of agreements had been negotiated with municipal governments, setting target maximum rates of growth for expenditure in real terms, in order to arrest the increase in the government-sector share of GDP. In 1977, a target revenue ceiling based on the 1977 tax-GDP ratio was also adopted. (These policy initiatives were supported by corresponding monetary, exchange rate, and additional incomes-policy actions, described in other chapters.)

The large, Central Government, post-oil-shock deficit fell nearly to zero in 1976, and then widened steadily over the succeeding four years as the scope for a reflationary stance reappeared (Chart 5). Central Government expenditure stabilized after 1977 as a proportion of GDP, and the broader, general government aggregate declined noticeably, in marked contrast to the immediately preceding years, which had seen a comprehensive reform of public schooling and a significant increase in public hospitals and health clinics.^{1/} On the revenue side, both Central Government and general government receipts declined sharply as a proportion of GDP for three years in succession, starting in 1977.^{2/}

^{1/} Health facilities and education are primarily municipal expenditures but are heavily supported by Central Government grants. See Section 5, below.

^{2/} Of the decrease of 3 1/2 percentage points from 1977 to 1980, a third is attributable to gradually moving forward the repayment of excess income tax withholdings, a temporary effect matched by an equal increase in the ratio in 1981-82. See Section 2a.

The adjustment that followed this fiscal reorientation proceeded further in reducing inflation and the current account deficit than was originally foreseeable. This was a consequence of the unexpected severity and duration of the recession. Correspondingly, unemployment remained critically high and did not begin to abate until after strong output growth commenced toward the end of 1978. The goal of the 1979 budget, prepared in mid-1978, was again to reduce inflation and unemployment by restraining cost increases in the business sector. However, in the supplementary budgets presented during 1979, some further increases in employment support programs were added (following a significant expansion in 1978). As a result of these measures and of grants to industry, notably in connection with an arrangement to stabilize petroleum prices, ^{1/} transfer expenditure grew by 19 per cent, a rate half again as high as that of other expenditure items. The Central Government deficit increased by 1 per cent of GDP in what was to be a year of strong recovery.

The level of public indebtedness increased rapidly in the five years to 1980. Following budget surpluses in the early 1970s, government debt amounted to no more than 3 per cent of GDP at end-1974, about 13 per cent of Central Government expenditure. By the end of 1979 it had increased to 10 per cent of GDP, roughly the same as at the close of the 1960s. Until 1979 the increase in government indebtedness was more than matched by the acquisition of claims on the domestic nongovernment sector. Debt service increased more than proportionately with indebtedness, particularly since in most years half or more of the requisite financing was obtained abroad. Given the underlying strength of the economy, no difficulty was encountered in raising foreign loans.

2. Fiscal developments in 1980

a. Proposed budgetary measures

The ordinary budget for 1980 was submitted to Parliament in September 1979 and approved in December. Underlying the budget proposals, it was assumed that the rate of increase in consumer prices would again average 7 1/2 per cent in 1980, although the 60 per cent increase in the U.S. dollar price of crude oil by mid-1979, when the budget proposals were formulated, was recognized as posing a new threat to price stability. A deceleration of GDP growth to a still vigorous 4 per cent was also anticipated, along with a widening of the external deficit. The unemployment rate, equal to 6 1/4 per cent at mid-1979, was expected to fall to 5 per cent in 1980, primarily because of employment-supporting measures.

As in the recent past, the primary objectives of the budget were to reduce both inflation and unemployment. Minimizing the rise in unit labor costs and other costs was seen as fostering the competitiveness of private industry, thus bolstering the increase in output for domestic and foreign markets, and hence employment. Accordingly, most proposed increases in indirect taxes and in prices charged by state enterprises were kept at or below the inflation

^{1/} The Price Disparity Equalization Scheme was established to even out the impact of fluctuations in the world market prices of sugar and oil on domestic prices, especially with respect to purchases made on spot markets.

rate--6 per cent for alcohol and tobacco, 7 1/2 per cent and 8 per cent, respectively, for rail freight and passenger rates, but 14 per cent for fuel. A general adjustment of 7 1/2 per cent in income tax brackets and most allowable deductions was proposed, in line with the ongoing understanding with employee organizations that such tax relief would be reflected in the next wage settlement. Among changes affecting producers, the exemption of investments in industrial buildings from the sales tax was extended through 1980, and the reduction in the rate on equipment was renewed at one third (down from one half) the normal 14 per cent. On the other hand, employers' contributions to employees' social insurance plans were increased, net, by 1 per cent of wage and salary payments. Parliament again insisted on the early reimbursement of a portion of excess income tax prepayments.^{1/} Funding was provided in the budget proposals for continuation of the recent employment measures, the energy program, support of industrial research and development, and the longer-term expansion of coverage of major social welfare programs then nearly completed, as well as for more traditional concerns.

b. Outturn for 1980 ^{2/}

Both in the 1980 budget proposal and in the three supplementary budgets that followed, major new spending initiatives were avoided. The economy experienced more rapid growth during the year than had been foreseen when the proposals were prepared, so that the increase in revenue exceeded expectations. Inflation had accelerated significantly, adding to government costs. The supplementary budgets, in the main, provided for the adjustment of spending and borrowing levels in line with actual developments, as is usually done in Finland.

^{1/} In 1976, a decision was made to postpone the refunding of 1975 excess tax prepayments from December 1976 to March 1977. Recorded 1976 revenues were correspondingly larger, the Central Government deficit smaller, than would have occurred with no timing change. The refunding due in December 1977 was also postponed to the following March. In subsequent years, however, a portion of the reimbursement was shifted back to December, with the opposite effects on the budget data: in 1978, one third (an estimated Fmk 730 million) was shifted from March 1979 to December 1978; in 1979, one-half (Fmk 1,140 million); and in 1980 the full amount (Fmk 2,180 million). According to present policy, the full refund will be made in December from now on.

In both 1979 and 1980, income tax withholding rates were reduced in order to make prepayments more nearly equal to eventual tax liabilities. Prepayments still average about one fifth more than liabilities in the case of those households for which withholding rates result in overpayment, but in the aggregate are approximately equal in value to the amount by which other households' prepayments fall short of their eventual liabilities. Withholding tax deficiencies are more likely in households with more than one income earner, but depend also on the deductions claimed in individual cases.

^{2/} Figures on government expenditure are on a cash basis unless otherwise specified.

Central Government revenue increased by 16 per cent in 1980, much faster than in preceding years (Tables 8 and 9). This was in large part attributable to the high rate of growth of national income resulting from the strong performance of the economy. Income and property tax payments increased especially rapidly, by 29 per cent compared with 2 1/2 per cent in 1979. The lag in the inflation adjustment of personal income tax scales and deductions added to this increase; since the adjustment reflects the inflation rate of the preceding year, and in 1980 the inflation rate accelerated markedly, an increasing proportion of earnings became subject to higher marginal tax rates. The growth of income and property tax revenues was also affected by factors connected with the end of the practice of postponing tax refunds (which, by convention, are counted as negative revenues). In 1980, the local authorities and the Social Insurance Institution took part for the first time in the "early" refunding of excess prepayments. Without the influences of this change and that of the postponement of 1979 refunds (a negative effect on 1980 revenue growth), income tax receipts would have increased only about 14 per cent in 1980.

Because nominal GDP growth in 1980 was rapid, the high rate of growth of overall Central Government revenue did not result in any appreciable increase in the tax-GDP ratio (Chart 5). Sales tax receipts increased by 15 per cent in 1980, virtually in line with the value of domestic product. Customs duties and import charges and levies together rose 25 per cent because of the large increases in both import prices and volume. The tax yield from excise duties increased little faster than the average level of consumer prices.

Central Government expenditure grew by 13 per cent, 3 percentage points less rapidly than revenue (Table 10), despite increased costs stemming from the higher inflation rate. The rapid pickup in economic activity then occurring permitted a slight reduction in grants to the unemployment compensation fund. More significantly, there was a deceleration in the growth of transfers connected with agricultural price subsidies and with payments to even out crude oil price fluctuations, in both cases following abnormally large increases in 1979. Total transfers, which account for roughly half of expenditure, grew by 12 1/2 per cent in 1980, compared with 19 per cent a year earlier. In real terms, transfers were constant. By contrast, Central Government consumption increased by 16 per cent, as fast as revenues, or by 3 1/2 per cent after adjusting for price increases. Compared with the overall target limit of 2 per cent, growth of total Central Government expenditure was more than adequately contained at about 1/2 per cent in real terms. (Values for the deflators for Central Government expenditure are given in Table 8.) In negotiations during 1980 with the three associations representing municipal governments, the target maximum rate of growth for government expenditure in real terms was revised upward to 3 per cent for 1981-82. ^{1/}

^{1/} The so-called "Arrangement Document," which has been renegotiated on average every three years, was signed June 12.

The Central Government deficit declined from Fmk 4.7 billion to Fmk 4.1 billion--from 2.9 per cent to 2.2 per cent of GDP (Table 8). An amount equal to about half of the deficit was financed through borrowing from the nonbank private sector, somewhat more than a third from foreign sources, and a quarter from domestic commercial banks; the government increased its net claims on the Bank of Finland by an amount equivalent to about 10 per cent of the deficit (Table 11). This pattern is similar to the one of the preceding year, but contrasts with 1978 when the deficit was more than covered through foreign borrowing.

c. Countercyclical measures

Besides the fiscal impact of decisions relating specifically to revenues and expenditures, a set of countercyclical policy tools, having fiscal-like effects, was utilized by the Government during 1980. It was expected that domestic demand would continue to grow strongly during that year, leading to bottlenecks, while in 1981 the buoyancy of the economy would be reduced by weak conditions in foreign markets. Accordingly, Fmk 540 million of public funds (about 1 per cent of total revenue) was transferred to the government countercyclical account. 1/ In addition, in May the Government activated a system of mandatory export deposits. 2/ Only two commodities, sawn timber and pulp, fulfilled the conditions of the plan--that a product be significant in Finland's total exports and experience rapidly rising prices. The deposits were intended to help contain a possible tendency for temporarily high prices to result in high wage settlements and--in some cases--raw material price increases in the affected industry, increases that could spread throughout the economy. Payments of 3-4 per cent of export proceeds were to be made for one year into a blocked account. After a period of at most three years, the deposits were to be repaid, with some interest. Also in May, the Government deferred to 1981 certain capital expenditures from its own budget and urged commercial and industrial firms to do likewise. (Some public spending had been deferred to late 1980 from a year before, reducing the net effect of this measure.) In October, the countercyclical effects of the export deposits were reinforced by the collection, for one year, of similar deposits from enterprises in general, equal to 5 per cent of taxable income. Starting in November, a special one-year tax of 40 per cent was levied on some types of new construction, 3/ also in an attempt to shift a portion of private investment spending into a countercyclical time schedule.

1/ The countercyclical fund dates from a 1970 law. Since each transaction requires Parliamentary approval--in this case, adoption of the third supplementary budget--the tool is not so flexible as some other measures and is used rather infrequently.

2/ Permanent authority for the present export deposit scheme was enacted in 1974, but voluntary payments were negotiated, instead of applying the Act's mandatory provisions, in the years up to 1980.

3/ The act applied to building projects of lower priority and located primarily in the southwestern (more urban) parts of the country. About 12 per cent of total construction was affected.

1. Fiscal developments in 1981

a. Proposed budgetary measures

The ordinary budget for 1981 was submitted to Parliament in September 1980 and approved at the end of December. At the time of its preparation, a considerable slowing of the overall growth rate was in prospect, largely reflecting developments in the international economy, along with a reduction in the inflation rate and a continuing sizable current account deficit. In the event, the output forecast was rather accurate, while the authorities were optimistic about inflation and pessimistic about the external balance.

The primary goal of the proposed budget was to prevent the acceleration of inflation. Emphasis was also given to the related objectives of restraining the rise in producers' costs, promoting the appropriate timing of investment expenditure in order to avoid further bottlenecks, and fostering a moderate incomes settlement by preventing tax-push inflation. The major new programs of recent years continued to receive funding. This group included, notably, the energy program, vocational training and other employment measures, research and other activities promoting the competitiveness of the Finnish economy, and the continuation of the recent comprehensive reforms of the social insurance system.

In line with the practice established in recent years, income tax brackets and major deductions were adjusted for the rate of inflation--generally by 11 per cent, compared with an eventual 11.6 per cent increase in the consumer price index in 1980. Excise taxes on alcohol and tobacco also increased by 11 per cent, rail fares and freight rates by 15 and 13 per cent, and most postal rates by 5 per cent. Sales tax concessions on investment goods were again extended, this time through the end of 1981. (This extension was adopted in May 1980 to avoid any further procyclical bunching of investment outlays toward the end of the year, in anticipation of the expiration of the concessions.)

b. Outturn for 1981

It is expected that a total of three supplementary budgets will be presented during the year, but that none of them will contain major spending initiatives. The first, approved in June, provided for some increases in the level of aid to Finnish industries and the second, submitted in September, for increases in the lending capacity of the State Investment Fund and the Regional Development Fund and in certain direct employment support programs. The second supplementary budget was financed mainly out of a drawing from the government countercyclical fund. The third supplementary budget is expected to adjust budgeted expenditure levels for unanticipated intra-year price increases.

According to official estimates, total expenditure of the Central Government will grow by 14 1/2 per cent in 1981 relative to actual expenditure in 1980 (Table 12), or 2 per cent in real terms (Table 8). This is well within the target maximum growth rate of 3 per cent. Consumption expenditure

is expected to grow at the same rate as overall spending, while transfers are projected to increase 2 percentage points faster. Fixed investment is expected to increase by 10 per cent (to fall 1 1/2 per cent in real terms), and lending, including financial investment, to increase 4 per cent.

Revenue is estimated to grow faster than expenditure in 1981, by 18 per cent. This rapid increase includes growth of receipts from income and wealth taxes of close to 30 per cent for the second year in a row. As in 1980, the increase is caused by nonrecurring effects of changes in the timing of tax payments--1981 is the first year since 1977 that excess prepayments from only one earlier year have been refunded. In 1981, unlike 1980, the rapid Central Government revenue growth is not matched by an increase in nominal GDP, and the tax-GDP ratio for general government will increase a percentage point on this account. It remains well below its 1977 value, however; on a national accounts basis, the ratio is an estimated 39 per cent in 1981 compared with 41 1/2 per cent in 1977 (Table 14). Also reflecting this rapid growth of revenue, the cash deficit of the Central Government is expected to decline as a proportion of GDP from 2.2 per cent in 1980 to 1.7 per cent in 1981, or to about Fmk 3.5 billion (Table 8). It is anticipated that official foreign borrowing will be somewhat larger in relation to the cash deficit--about half, as compared with a third in the preceding year (Table 11).

c. Countercyclical measures in 1981

In view of weakening economic conditions, both in foreign markets and domestically, the special countercyclical measures introduced primarily in 1980 were gradually relaxed starting in 1981. As mentioned, the second supplementary budget was financed largely by a drawing of Fmk 200 million from the government countercyclical fund. Together with a somewhat larger drawing expected in 1982, this will offset the deposit of Fmk 540 million made in 1980. Meanwhile, export deposits were discontinued several months ahead of schedule, during March and April 1981, and the approximately Fmk 200 million collected by those dates is to be refunded early in 1982. The payments into countercyclical deposits made by enterprises in general were discontinued from July 1, 1981, after having been collected for nine months; the total amount deposited, in excess of Fmk 100 million, is also to be repaid in early 1982. In addition to these measures, voluntary payments made by firms out of profits earned during 1978-81 into an "investment reserve" fund, totaling Fmk 1,400 million, are being released gradually between October 1981 and April 1983. Thus, the total amount of funds to be returned to the business sector, or at least to be unfrozen, by the reversal of the stance of countercyclical policies, is approximately Fmk 1.8 billion. In addition to countercyclical deposits, the government has removed the 40 per cent construction tax that was introduced in November 1980. ^{1/}

^{1/} The tax was removed from the end of August for all localities in which it had been imposed except Helsinki, where it will remain in effect through February 1982.

4. Proposed 1982 budget

The proposed budget for 1982 was prepared during the summer of 1981 and submitted to Parliament late in September. The widely expected slowing of economic growth had just become apparent at the time it was drawn up, while prices continued to accelerate. The budget reaffirms the priority given in preceding years to containing the rate of price increase and is only marginally more stimulative than the budget for 1981. Again, there are no major spending initiatives in the new budget.

On the revenue side, the 1982 budget contains an important change, relating to the indexing of income taxes. While tax brackets for 1982 have been adjusted to offset the effects of the inflation rate in 1981 (an estimated 12 per cent), the basic deduction from earned income has been increased by only 6 per cent. This constitutes a break with the practice started in 1977 of adjusting income taxes fully for inflation in order to avoid creating a tax-push component of wage increases. In other respects the revenue provisions of the 1982 budget resemble those of the preceding year. The prices of tobacco products, alcoholic beverages, passenger rail fares, and some postal rates are raised by 12 per cent. Sales tax concessions on industrial investments are extended at their present level (one third for machinery and 100 per cent for structures) through the end of the year. The implementation of medium-term social reforms is continued, including child day-care and public health programs and the extension of the employee pension scheme to cover farmers and other self-employed persons (see Section 6). Appropriations for the improvement of real competitiveness of Finnish products are emphasized, such as expenditure on energy conservation and the promotion of technological and commercial research.

Total revenue is budgeted to grow by 12 1/2 per cent in 1982 and expenditure by 13 per cent. (These rates are in relation to the official estimates of actual revenue and expenditure for 1981 described above; relative to the 1981 ordinary budget, both revenue and expenditure will grow by 15 per cent in 1982.) The deceleration of revenue growth from an estimated 17 per cent in the preceding year (and of income and property tax receipts from 29 per cent to 14 per cent) reflects, especially, the end of the effects of changes in the timing of tax collections. Income tax receipts continue to grow faster than projected personal income because of the gradual phasing-in of taxation of social insurance benefits during 1982 and 1983 and the incomplete adjustment for inflation of the basic tax deduction. Revenues from other sources also decelerate to some extent in 1982 because of the significantly lower rate of inflation underlying the budget proposal.

Budgeted consumption is 13 per cent higher than the estimated 1981 out-turn, a real increase of 3 per cent, equal to the target ceiling rate for general government. Transfers increase by 20 per cent (covering day-care, public health, aid to industry, and grants to facilitate expanded pension coverage), while both investment and lending to the private sector decline in nominal terms. In order to restrict the budgetary cost of state loans at subsidized interest rates, a system of subsidies graduated according to the age of the loan is proposed.

The deficit in the ordinary 1982 budget is Fmk 4.1 billion. This is virtually the same proportion of GDP, 1.8 per cent, as expected for 1981. Because of financing considerations, gross long-term borrowing is projected at a higher figure, Fmk 6.6 billion. This sum constitutes a significant increase relative to the expected deficit, compared with the borrowing undertaken in 1980 and 1981 (Table 11). The increase is related to the heavy volume of redemptions to be made during 1982.

5. Local government finance and the social insurance accounts

In Finland there are 461 individual municipalities and some 435 specialized intermunicipal associations, the latter providing schools, hospitals and health clinics, or other social services on a joint basis. The largest source of municipal government revenue is the local income tax. Tax rates are set provisionally for each tax year, based on estimated revenue needs, then adjusted after actual expenditures and taxable incomes for the period are known. The municipal governments themselves determine the funding levels for a number of their activities, but expenditure in some important areas (education, social relief, hospitals, and public health clinics) is mandated by Parliament and funded by the Central Government according to the type of activity and the financial strength of the local authority. 1/

While they do not share responsibility for setting discretionary fiscal policy, the municipal governments account for a substantial portion of total public spending and taxing (Table 13). Apart from intergovernmental transfers, expenditure at the central and local levels are similar in size--Fmk 38 billion and Fmk 29 billion, respectively, in 1980. Social insurance benefit payments and administrative expenses, comprising the remaining component of general government expenditure, amounted to Fmk 11 billion in 1980. 2/ On the other hand, reflecting the large transfer flow from the Central Government to local authorities, revenue collected by the state is more than twice as large as that collected by municipalities, Fmk 44 billion compared with Fmk 18 billion in 1980. The social insurance accounts are funded predominantly by contributions but also receive significant income in the form of transfers from the Central Government and municipal governments, accounting for 15 per cent of total income in 1980.

Total receipts of local governments increased by 14 1/2 per cent during 1980, transfers roughly twice as fast as tax revenues, 19 1/2 per cent and 11 per cent respectively (Table 13). Revenue growth fell short of the increase in the wage bill largely because of the change in the tax collection system, according to which the municipalities participated for the first time in 1980 in the "early" refunding of excess tax prepayments (see Section 2a).

1/ Municipal governments are divided into ten groups, based partly on relative per capita tax base. Central Government grants are redistributive, ranging usually from 20 to 90 per cent of the cost of a program for the strongest and weakest groups, respectively.

2/ The Central Government data cited here, as before, are on a cash basis (Table 8). For the sum of the municipal authorities and for the social insurance accounts, only figures on a national accounts basis are available.

Total expenditure by local authorities increased 1/2 percentage point faster than receipts, by 15 per cent; this rate amounted to 2 1/2 per cent in real terms (using the Central Government expenditure deflator), which is within the target maximum. According to official estimates, revenues will increase more rapidly in 1981, by 16 1/2 per cent, despite the marked fall in the rate of growth of the wage bill, because of the sharp increase in revenues from direct taxes following the timing adjustment in 1980. Expenditure growth will accelerate by half a percentage point, to 15 1/2 per cent, implying a slight increase in the real growth rate, up to the target maximum. The budget deficit of the local authorities (here defined as the current operating surplus less gross capital formation, both on a national accounts basis) in 1980 and 1981 remains in the range of one quarter to one third per cent of GDP, the same proportion as during the late 1970s.

In 1982 growth of municipal government spending and tax yields are both expected to decelerate by 1 percentage point in real terms. The nominal growth of receipts, which will continue to exceed that of the wage bill, will reflect the taxation of social insurance benefits, to be implemented gradually during 1982 and 1983. (This extra revenue is largely offset, as regards the municipalities' budget balance, by a rearrangement of benefit payment shares with the Social Insurance Institution and the Central Government.)

Despite the relative stability of the growth of local government spending and income flows, some structural changes are underway. The near completion of the comprehensive reform of the basic educational system and public clinic and hospital networks means that the growth of transfers from the Central Government will continue to slow, possibly falling behind the growth of local tax revenues in the near future. Meanwhile, local governments are expanding certain social services, notably day-care facilities for children of employed parents and special training facilities for the handicapped. Scope for reducing local expenditures has appeared in the form of smaller primary- and secondary-school-age populations. Unlike the pattern of Central Government expenditure, fixed investment by municipal authorities has continued to grow slightly in real terms in recent years.

The social insurance accounts tended to show smaller surpluses in the later 1970s. In part this was due to high unemployment compensation payments, and in part to the reductions made in contributions to the funds since 1977 as an aspect of the cost-containment policy of the Central Government. 1/

1/ Insured persons' national pension contributions were reduced from 2 1/4 per cent to 2 per cent of income subject to local income tax, comparing average rates in 1977 and 1979, and health insurance contributions from 1 1/2 per cent to 1 per cent. Employers' contributions to employees' health insurance were reduced from 1 7/8 per cent to 1 3/4 per cent of total wages and salaries paid, and contributions to the fund for child allowances were reduced by 1 1/2 points; child allowances were permanently discontinued after February 1981. Unemployment insurance contributions were reduced by 0.1 per cent, to 0.9 per cent in 1980, and to 0.4 per cent in 1981. The Central Government has offset part of the effects of these reductions by increasing its own contributions out of general revenues to the various insurance accounts.

In 1980 the balance on the accounts improved despite the implementation of the first phase of the national pension reform (see Section 6). Starting in 1982 or 1983, most types of social insurance benefits will become subject to income tax at the same time that national pension benefits are made less conditional with respect to receipt of other income. Despite the expected higher net flow of benefit payments, contribution rates are not to be raised (with the exception of employers' health insurance payments, from 1.75 to 2.35 per cent of the wage bill). Taxation of social insurance benefits is expected to add about 1/2 per cent to the gross tax-GDP ratio for the economy, bringing it to 39.5 per cent (on the basis of the definitions employed in Table 14), compared with 41.5 per cent in 1977.

6. Pensions and pension reform

There are two comprehensive pension schemes in effect in Finland. 1/ The national pension scheme is administered by the Social Insurance Institution, a public body the transactions of which are counted as part of general government. Contributions are collected in connection with the tax system, from employers and from insured persons, but entitlement to pension benefits is not conditional on contributions. Benefit payments are funded out of the current income of the system. Income in the form of contributions is supplemented by grants from the Central Government out of general revenues; contribution rates for national pensions have remained constant since 1978. This pension scheme is sometimes referred to as the "flat-rate" scheme because each person is entitled to the same basic unconditional benefit payment. This was Fmk 194, or SDR 40, per month in February 1980. However, retirees may also be entitled to supplements and allowances, ranging up to Fmk 1,765 per month for a solitary pensioner (not including survivors' or orphans' benefits nor assistance in respect of ill-health or rehabilitation), which are conditional on locality of residence, age, and other income received by the insured or the spouse of the insured. In fact, the average pension at the end of 1979 was Fmk 560 per month.

The other comprehensive pension plan is earnings-related, the so-called employee pension scheme. Though this group of programs is administered by private companies, the contribution rates are set by Parliament, and income of the system is supplemented from Central Government revenues. Employee pensions are partly funded, with less than half of income (including governmental transfers) going to pay for benefits in the same period. Contributions are paid by employers 2/ and are expressed as a per cent of total wages and salaries paid out; the basic rate has been varied in recent

1/ "Pension" refers here to retirement or old-age benefits, and excludes disability, survivor, and unemployment benefits, even though they may be provided by the same programs and institutions.

2/ This applies if the pension benefits are payable at the statutory "minimum" level. If the employer decides to institute a more generous scheme, employees can be charged for part of the difference.

years as a tool of macroeconomic policy--to offset inflationary shocks arising abroad and cyclical changes in domestic business activity. 1/ More than half of the contributions are automatically loaned back to the contributing firms by the scheme, currently at a nominal rate of interest of 8 1/2 per cent. The benefit entitlement under this scheme amounts to 1 1/2 per cent of preretirement pay per year of employment, up to a maximum of 60 per cent. Since the plan has been in effect for only 18 years, present benefit payments are typically much less than 60 per cent. The average monthly benefit for retired private-sector employees under this plan was Fmk 624 per month in the first half of 1979.

During the past decade, extensive reforms of both pension schemes have been formulated, involving significant increases in benefits and costs. Starting in the early 1970s, coverage under the employee pension scheme was gradually extended to farmers and other self-employed persons. Largely as a consequence, the number of enrollees in the plan increased at an annual average rate of 18 per cent over the first half of that decade, dropping to an expected 4 per cent per year during 1981-85. This extension, plus the normal growth of entitlement to 60 per cent of earnings as the scheme matures, and the ongoing shift in the age composition of the population from the under-65 to the over-65 subgroup, will on average add an estimated 1/2 per cent per year for the indefinite future to employers' labor costs.

In addition to this reform of the employee pension scheme, a major increase in benefits payable under the national pension scheme is also underway, to be implemented in stages starting in January 1980 and ending around the middle of the decade. The reform of the national scheme will, among other things, reduce the "penalty" for receipt of other income by the insured person or by the spouse of the insured. That is, receipt of benefits from both of the comprehensive schemes--an increasingly typical case--will no longer result in a lessening of benefits from the national plan. The pension benefits do become subject to income tax at the beginning of 1983, offsetting approximately a quarter of the cost of the liberalization. 2/ It has been agreed that the contribution rates of the national scheme will not be increased above their present values.

1/ From 12 per cent in 1977 (annual average), the rate was lowered to 10 per cent in 1978, then raised in two steps to reach 13.3 per cent by 1980, and lowered to 12.4 per cent at the beginning of 1982. These changes are quite substantial relative to those affecting sickness insurance and unemployment insurance. Only the elimination, between 1977 and 1981, of employers' contributions to child allowances can have had a comparable effect on the rate of business cost increases.

2/ The taxable income of persons whose sole source of income is their national pension benefit payments will, however, generally be below the bottom tax bracket.

7. The impact of fiscal policy

One aspect of the fiscal strategy pursued by the Finnish authorities is not directly quantifiable. That is the emphasis placed on reducing the growth of government sector output--by limiting the growth of expenditures to a rate no greater than the growth of potential output, and by limiting the gross tax burden to a fixed share of GDP. The resources thus freed, as well as the potentially favorable effects on investor confidence, inflationary expectations, and competitiveness, are believed to contribute significantly to the growth of output and employment. It is judged that the opposite policy, one of rapid expansion of government expenditure relative to potential GDP, could result in price rises without production increases. A policy that is expansionary (or reflationary) according to supply-side logic might, thus, be judged restrictive by the cyclically-neutral-budget concept, and vice versa.

Nevertheless, the supply-side policies will tend to produce effects in the medium term, while in the short run "demand-side" effects from larger or smaller deficits or surpluses will continue to occur. Four measures of fiscal stimulus to aggregate demand are presented in the table of figures below. The first line gives the surplus or deficit of the Central Government on a cash basis as a per cent of GDP. In the second line are the budget balances for general government (including municipal authorities and the social insurance funds) on a national accounts basis. The third line contains estimates prepared by the Ministry of Finance of the general government balance on a high employment basis. The fourth line gives estimates of the impact of government spending and taxing on the growth rate of real GDP (the change in the "weighted budget balance," or "Bent Hansen" approach).

Surplus or Deficit of Government Budget

(In per cent of GDP)

	1977	1978	1979	1980	1981
Central Government, cash basis	-1.2	-1.8	-2.9	-2.2	-1.7
General government, national accounts basis	2.3	0.5	-0.3	-0.1	0.5
General government, national accounts basis, high employment balance	5 1/4	3	1 1/4	1	1 3/4
General government, change in weighted budget balance (sign reversed)	...	...	1.1	0.2	--

As shown in the first line, the deficit in the accounts of the Central Government was not eliminated with the resumption of strong economic growth in 1979. This imbalance has become structural and stems from the decision to curb the growth of tax revenues more severely than that of expenditures, through lowering income tax rates and capping social insurance contribution rates. The figures in the second line show that the consolidated general government budget on a national accounts basis has remained in surplus, or only slightly in deficit, during the recent recession and recovery. The differences between the first two lines arises, importantly, from the exclusion in the second line of the acquisition by government of claims on the private sector; at all levels of government, the public authorities engage in significant lending--primarily in the form of home mortgages--which for many years substantially exceeded the Central Government deficit on a cash basis. The figures do show, however, that the size of the general government surplus relative to GDP has shrunk significantly in recent years (see also Chart 5).

The stance of policy is probably better judged from the calculations in the third line. On a high-employment-budget basis, stimulus equal to over 2 per cent of GDP was added via the public sector in 1978, and again nearly 2 per cent of GDP in 1979, in each case relative to the preceding year. By comparison with the second line, it can be inferred that this stimulus is understated in the crude overall balance figures for 1979, which change less because the spurt of activity generated extra revenues. Since 1979, changes in fiscal stimulus have been small, a slight further addition in 1980 and an estimated modest withdrawal in 1981.

The last line of the tabulation shows a measure of fiscal impact in which government spending and taxing have been adjusted, category-by-category, for estimated "leakages" from the income-spending flow into (or out of) savings and imports. The figures are changes in the so-called weighted budget balance, with sign reversed. That is, in the first three lines of the tabulation, a decrease (increase) corresponds to addition (withdrawal) of stimulus; in the fourth line, a positive (negative) number corresponds to addition (withdrawal) of stimulus. The growth rate impact figures yield roughly the same qualitative assessment of changes in the stance of fiscal policy as the high employment budget calculations. There is a strong addition of stimulus in 1979 but in 1980 the fiscal stance is only slightly expansionary. For 1981 the high employment balance suggests some withdrawal of stimulus, while the weighted budget balance indicates little change.

III. Money and Credit

1. Background

Despite restraints on private capital movements, external developments, notably fluctuations in export earnings, have nonetheless posed some difficulties for the pursuit of monetary policy in Finland. 1/ This is particularly true since one objective of the Finnish authorities has been to stabilize the exchange rate in terms of a basket of currencies. The large size of the traded goods sector 2/ and its concentration in cyclically sensitive commodities have resulted in sharp swings in the current account balance. Such movements have at times been aggravated by private short-term capital flows. When such developments coincide, they give rise to substantial movements in domestic liquidity. More generally, however, borrowing by the corporate sector has largely financed the current account deficit, though, in recent years, public borrowing from abroad has increased in importance. Capital flows--notably the net inflow of medium- and long-term capital--remain an important means of influencing domestic financial conditions. However, the Bank of Finland also employs an intricate set of quantitative and interest rate measures, and relies on moral suasion to influence the development of the net domestic asset component of reserve money. 3/

The Finnish financial sector is oligopolistic in structure and the money and capital markets are relatively thin. Thus financial sector policies must make allowance for the market structure and the control of the net domestic asset component of reserve money cannot be effectively carried out by open market operations. The Bank of Finland has therefore developed a set of monetary policy instruments suitable for these conditions, with which it can influence both the price and the quantity of its credit to financial institutions, emphasizing, at a time, the one or the other variable.

Most interest rates in Finland are administered and have behaved quite stably (Chart 6). In particular, the Bank of Finland effectively regulates both deposit rates and maximum lending rates, and these rates tend to move in line with the discount rate. Although it also monitors average lending rates of banks, these can fluctuate somewhat in response to changes in the structure

1/ Short-term trade-related capital transactions have been liberalized, but other capital flows are still subject to controls.

2/ Both exports and imports of goods and services exceed 30 per cent of GDP.

3/ In line with IFS terminology, reserve money is defined as currency in circulation plus banks' reserve and other deposits plus working balances of the private sector, all held with central bank. The reserve money concept is, in the case of Finland, not thought to have the same importance for the analysis of monetary conditions and the stance of monetary policy as in many other countries. Since the inception of the cash reserve deposit scheme in April 1979, movements in reserve money have reflected primarily changes in reserve requirements. Furthermore, because of banks' virtually unlimited access to central bank finance, the rigidity of interest rates, and the importance of credit rationing by banks according to profitability considerations, variables other than reserve money must be examined to come to an integrated view of both domestic financial conditions and the stance of monetary policy.

of bank lending. Real interest rates on deposits, as well as those for borrowing from commercial banks, have more often than not been negative (Chart 6). Their movement has reflected primarily changes in the rate of inflation rather than adjustments in nominal interest rates.

Reflecting the recurrent balance of payments deficits of the country and private sector financial savings, which consistently used to fall short of this sector's credit demand (Chart 7), the Finnish financial institutions have usually been dependent on central bank credit for their own credit expansion. Such credit has been made available to them in the first instance by the Bank of Finland within prescribed and frequently adjusted quotas at the discount rate. 1/ Access to further credit has been granted in multiples of quota at increasing supplementary rates. Given the simultaneous virtual control by the Bank of Finland over lending rates of banks, borrowing in higher credit tranches thus reduces the profitability of banks' lending activities 2/ and thereby affects their ability and willingness, over time, to extend credit to the private sector. In the short run, however, banks are generally able and prepared to borrow liberally from the Bank of Finland, if special circumstances warrant the related increase in the costs of their resources, so that central bank credit is thus largely demand determined. As a result, the operations of the financial sector have gained a high degree of short-term flexibility. At the same time, the central bank has in principle retained its power to control the growth of liquidity over the longer term through adjustments in the terms and conditions of its credit and through changes in quotas, all of which affect banks' preparedness to lend via their influence on profitability. As measures affecting the terms, conditions, and availability of central bank credit can work as an effective policy tool only as long as banks need to supplement their own resources through central bank credit, cash reserve deposit requirements, which increase banks' need to borrow from the central bank, have at times been introduced during periods of ample liquidity.

A number of special policy arrangements supplement the basic instruments for monetary management by the Bank of Finland. They are generally referred to as countercyclical arrangements, and include the transfer--and later release--of State funds 3/ to a "government countercyclical fund," as well

1/ As will be described in more detail in the next section, central bank credit extension at first consisted mainly of discounting bills. This practice was discontinued after June 1979, and was replaced by check account and call money overdraft facilities.

2/ Given generally parallel adjustments of deposit and lending rates, the spread between costs and returns on lending out of deposits is thus relatively fixed, while the spread for lending out of borrowed domestic resources varies with adjustments in central bank interest rates and with changes in the multiple of the quota within which borrowing from the central bank takes place and which determines the supplementary rate applied. Both measures affect the average cost of borrowing from the Bank of Finland and lead to changes in the relation of this cost to banks' average lending rate (Chart 6).

3/ The Government has, for many years, consistently been a net lender to the Bank of Finland (Chart 8).

as the sale of certificates of deposit to absorb liquidity. 1/ During economic upswings, the authorities have also encouraged firms to deposit part of their financial resources in a special investment fund for a time. They have at times also required the making of deposits out of firms' profits. Finally, compulsory export deposits and capital import deposits have intermittently been used to even out fluctuations in the supply of liquidity in connection with foreign sector transactions. 2/

Apart from monetary policy measures aimed primarily at short-term monetary management, the Bank of Finland has taken various measures to influence the allocation of credit. These include, inter alia, recommendations on the differentiation of interest rates according to the activity of the borrower and/or the purpose of the loan and, frequently, the issuance of guidelines to banks recommending that certain types of economic activities be favored or discouraged at a particular point in time. Generally, investment and export activities have been favored, while consumption and imports have been discouraged. Finally, the Bank of Finland has also resorted increasingly to direct lending (special financing arrangements) 3/ in cooperation with the banks, to various nonbank sectors of the economy, in order to further influence the allocation of credit.

Existing regulations guiding financial sector activities, the stickiness of interest rates, controls on capital movements, and generally negative real deposit rates, have probably all contributed to the emergence and growth of "gray" financial markets. Insurance companies, pension plans, and the larger firms are among the major market participants. Large amounts of money are lent on a short-term basis.

2. Monetary policy since 1979

a. Quantitative and interest rate measures

Owing to the emergence of a sizable current account surplus and substantial foreign borrowing by the Government, net foreign assets of the Bank of Finland increased sharply in 1978 (Table 15). Since domestic credit demand had at the same time remained sluggish, reflecting in particular the weak

1/ Such sales have primarily been to the Government, in an attempt to even out the liquidity effects of official foreign borrowing. More recently, however, they have become a more active tool of short-term monetary management.

2/ Countercyclical deposits and export levies are imposed and collected by the Government. However, the Bank of Finland takes part in the decisionmaking process and serves as a depository. Enterprises' investment reserves (including those held at the Bank of Finland) benefit from favorable tax treatment. All these instruments may therefore be considered both monetary and fiscal policy instruments. Hence they are also covered in part in Chapter II.

3/ The special financing arrangements comprise the domestic suppliers' credit scheme, the new export credit scheme, and the short-term export credit scheme. These schemes are described in SM/78/124 (5/4/78), p.39. From the viewpoint of monetary policy, they are distinct in that the credit provided through them is not included in the commercial banks' quota.

investment climate, developments in the financial markets were characterized by a strong growth of liquidity. Banks sharply reduced the use of central bank credit (Table 15 and Charts 8 and 9). The progressive decline in the commercial banks' debt to the central bank continued throughout the first half of 1979 on account of a strong inflow of capital. This development undermined the traditional approach to monetary management focused on controlling the excess demand for credit from the central bank and brought about important changes in the framework of monetary control.

In an attempt both to reduce liquidity and to adapt its set of monetary policy instruments to the change in circumstances, the Bank of Finland reached agreement, in March 1979, with the deposit money banks on a cash reserve deposit scheme. In the light of a strong growth of liquidity, a vigorous pick-up in economic activity, and an acceleration in the rate of inflation, the reserve deposit scheme was activated immediately. Banks were obliged to place 0.2 per cent of their deposit base at the end of April 1979 with the Bank of Finland by end-May. The reserve coefficient was thereafter continuously raised each month throughout 1979 to a level of 2.8 per cent in December. 1/ Further, effective April 1, 1979, the overall discount quota was reduced from Fmk 1 billion to Fmk 500 million, while the limit on call money debt was raised from 500 to 800 per cent of quota (Table 16). This decision underlined the intention of the Bank of Finland to eventually phase out discounting and to enhance the importance of the call money market as a conduit for monetary policy. 2/

1/ A cash reserve deposit scheme had last existed in the late 1960s. However, while at that time it had been introduced for a fixed period of time, the current agreement is open-ended. Under the agreement, the Bank of Finland is given the right to impose compulsory reserve deposit requirements on all deposit money banks. These include commercial banks, savings banks, cooperative banks, and the Post Office Bank; the relatively less important mortgage banks and savings associations are excluded. The requirement is expressed as a percentage of these banks' deposit base, defined as their total demand and time deposits denominated in Finnish markkaa plus half of residents' foreign currency deposits at the end of each month. (All deposits with banks by the Central Government, other financial institutions, and Finnish Export Credit Ltd., are excluded from reserve requirements.) The requisite sum has to be placed in an account with the Bank of Finland by the end of the following month. The reserve deposit ratio may be raised at a maximum rate of 0.4 percentage point per month, up to a ceiling of 5 per cent. Interest is payable on such deposits at an annual rate of 0.75 percentage point less than the prevailing discount rate. Any shortfall in deposits attracts penalty interest charges.

2/ The call money market was established by the Bank of Finland in 1975 as a deposit and overdraft facility, with the intention of evening out interbank differences in liquidity, including those arising from Government cash transactions between the banker of the Government, which is the Post Office Bank, and other deposit money banks. It only later became an active instrument of monetary policy.

In a further move to simplify the administration of its monetary policy, the Bank of Finland discontinued rediscounting and the related supra-quota borrowing with effect from July 1, 1979, and replaced it with a system of check account and call money account overdrafts. A new quota for banks' credit within the check account overdraft facility--defined as monthly averages--replaced the former discount quota and was set at Fmk 200 million (Table 16). While banks were not permitted to exceed on average their individual quota for the month, they were permitted to borrow up to 2.5 times their quota on a day-to-day basis if their liquidity situation warranted it. Credit in the form of check account overdrafts was granted at a basic rate, which continues to be called the "discount rate." Further credit was available to banks at higher cost in the form of call money overdrafts, for which an overall ceiling--defined as a monthly average--of Fmk 5 billion was established. ^{1/} As before, the interest rate in the call money market was to fluctuate within limits set internally by the Bank of Finland in accordance with demand and supply conditions, with the Bank of Finland intervening in the market whenever the rate exceeded or fell below these limits. Bank credit of last resort was made available on a temporary basis through bond repurchase transactions at interest rates considerably above the call money rate.

After the revaluation of the markka by approximately 2 per cent in effective terms in September 1979, capital flows (which had previously exercised a strong expansionary effect on liquidity) turned around and the net foreign assets of the Bank of Finland dropped sharply (Chart 8), thereby reducing the liquidity of the banking system, which was at the same time facing an increasingly vigorous demand for credit owing to the strong growth in economic activity and re-emerging inflationary pressures. The change in exchange rate expectations was only one of the reasons for the reversal of capital flows--the other being an increasing interest rate differential in favor of the Eurodollar market. The Bank of Finland increased the discount rate, effective November 1, 1979, by 1.25 percentage points to 8.5 per cent. In order to curb buoyant domestic credit demand, thereby preventing an overheating of the economy, as well as to protect the foreign exchange reserves of the Bank of Finland, deposit and lending rates of banks were raised in line with the discount rate. The call money rate rose steeply, partly as the result of a discretionary increase in the limits set by the Bank of Finland, and partly reflecting market factors. By November, the call money rate had risen to almost 13 per cent, compared with rates between 8 1/2 and 9 in the months before. By December, the rate had moved up further to 13 1/2 per cent.

Despite the interest rate measures taken in November, the outflow of capital continued in November and December and the Bank of Finland had to make large placements in the call money market to satisfy the liquidity

^{1/} In connection with these changes, and with a view to improving its liquidity management, the Post Office Bank was, for the first time, granted access to central bank finance, with an average monthly check account overdraft limit of Fmk 10 million, a maximum daily limit of Fmk 50 million, and a call money overdraft limit of Fmk 600 million.

needs of the economy (Table 15 and Chart 9). The Bank of Finland nevertheless continued its policy of raising the cash reserve deposit ratio. However, it provided the needed liquidity through a further expansion of call money advances. The pursuit of this policy resulted in a better balance between monetary instruments that were entirely under the control of the Bank of Finland, gave clearer signals of the Bank's policy intentions, and were of a more stable and permanent nature, and those which, because of their short-term and reversible character, were better suited for fine tuning, and, within the prescribed limits, were determined by banks' demand for credit. Mainly on account of heavy call money borrowing of banks, 1/ the rise in the Bank of Finland's net domestic assets exceeded the decline in its net foreign assets by a substantial margin, and reserve money grew at a rapid pace (Table 15). However, given the rise in the average cost of borrowing from the central bank due to increased bank borrowing in high-cost credit tranches and the strong expansion of economic activity, this growth nevertheless reflected a move of the Bank of Finland toward a policy of moderate restraint.

Economic activity remained unusually buoyant in the winter of 1979/80, and pressures on domestic prices increased. The Bank of Finland therefore decided to gradually strengthen monetary restraint and, at the same time, to modify the characteristics of its lending operations. Firstly, it further raised the cash reserve ratio by 0.4 percentage point to 3.2 per cent at the end of January 1980. Secondly, effective February 1, 1980, the overall quota for check account overdrafts was raised from a monthly average of Fmk 200 million to Fmk 1 billion, 2/ but the discount rate for borrowing within quota was raised from 8.5 per cent to 9.25 per cent. 3/ The absolute limit for call money overdrafts was abolished and replaced by a scaled, but in principle open-ended, overdraft system under which an amount of up to five times quota (i.e. Fmk 5 billion) could be borrowed at the prevailing call money rate. A further amount up to three times quota (Fmk 3 billion) would be made available at a supplementary interest rate of 4 per cent above the call money rate and, finally, an unlimited additional amount of finance (in excess of eight times quota) could be obtained by banks at a supplementary charge of 8 per cent. 4/ Apart from domestic considerations, the increase in the discount rate and the scaling of costs for call money advances was

1/ Call money borrowing by far exceeded the reduction of banks' financial resources due to the increases in the cash deposit ratio. Sizable transactions in the Government's holdings of certificates of deposit also contributed to the increase in liquidity (see Table 15).

2/ At the same time, the daily overdraft limits of banks were reduced from 2.5 to 1.3 times their respective quotas.

3/ Bank lending and deposit rates (with the exception of the rate on check and postal giro accounts) were also raised by 3/4 percentage point.

4/ This reform represented an effective reversion to the previous system of bank-by-bank quotas and a step away from a homogeneous short-term money market. The maximum call money rate, prescribed by the Bank Supervisors and defined as the upper limit for the sum of the call money rate and the supplementary charge on call money advances, was raised from 24 per cent to 24 3/4 per cent.

intended to narrow the gap between domestic and foreign interest rates which had continued to give rise to short-term capital outflows. The open-ended nature of the new call money system obviated the need for a further "lender-of-last-resort" scheme, so that the bond repurchase scheme was rescinded.

Since banks strongly increased their borrowing within the enlarged low-cost check account overdraft facility at the expense of the much more expensive call money borrowing (Table 15), the initial result of the measures was a decline in the call money rate and in the average cost of central bank credit in February 1980 (Table 17 and Chart 6). At the same time, the marginal cost had increased due to the scaling of call money interest rates. By March, the fall in the call money rate and in the cost of borrowing from the central bank had come to a halt. The current account deficit continued to rise and tax payments to the Government caused a fall in deposits with banks. While the Government experienced an excess of liquidity, which was partly sterilized by the purchase of central bank certificates of deposit, the banks borrowed heavily on the call money market (Table 15 and Chart 9). Consistent with its general stance of monetary restraint, the Bank of Finland allowed the call money rate to reflect the tightness of money markets and to rise again. Due to extensive loan commitments, some banks were particularly harshly affected by the overall liquidity squeeze, and had to borrow within the second quota tranche for the call money market at a supplementary rate of 4 per cent; their marginal interest cost thus approached 16 1/2 per cent, and the average cost of central bank credit rose to a level close to the call money rate.

In view of the threat to price stability, the continued strong relative cyclical position of Finland, and the related rapidly increasing current account deficit, the Bank of Finland decided to further tighten monetary conditions. The cash reserve deposit ratio, which had already been raised in two steps, from 3.2 per cent in February to 3.6 per cent in April 1980, was raised by a further 0.2 percentage point for the month of May. Further, effective June 1, 1980, the quota was reduced by Fmk 100 million to Fmk 900 million, with corresponding reductions in the limits for the two call money market tranches (Table 16). At the same time, the supplementary interest charge on borrowing in excess of the two tranches--i.e. in excess of eight times the quota (Fmk 7.2 billion)--was raised from 8 to 10 per cent, implying, at the time, a marginal interest rate of 22 1/2 per cent. As these measures appeared to exercise only a moderate effect on banks' borrowing, the Bank of Finland opted in August for a further tightening of monetary policy. The cash reserve deposit ratio was raised by 0.4 percentage point to 4.2 per cent. Further, the check account overdraft quota was reduced to Fmk 700 million, and the coefficients for the determination of the call money tranches were lowered from 5 and 8 to 4 and 7, respectively. The latter change was reversed in October, and the initial coefficients were re-established. 1/

1/ For the implications of these measures on the size of the call money tranches, see Table 16.

The August measures exercised a further strong effect on banks' average borrowing cost from the Bank of Finland. By September, these costs exceeded the call money rate by almost 1 1/2 percentage points and the average lending rate by more than 4 per cent 1/ as banks, partly owing to a drop in the growth rate of deposits, had to borrow increasingly within the second call money tranche or even above it to honor their loan commitments. Given unchanged lending rates, this rise in interest costs further eroded their profitability, which had already suffered since the interest rate hike at the end of 1979. Banks thus adopted a more cautious attitude toward lending, a result intended by the Bank of Finland. Total bank borrowing from the central bank declined somewhat in the third quarter of 1980. This decline was more than fully reversed during the fourth quarter, partly as a result of seasonal factors, and partly owing to a further fall in banks' liquidity due to monetary policy measures.

Effective December, the cash reserve deposit ratio was raised from 4.2 per cent to 4.6 per cent. In yet another move toward tightening liquidity, the banks' quota was reduced to Fmk 600 billion, with corresponding adjustments in the call money market tranches. A renewed rise in the average interest cost of banks' borrowing from the Bank of Finland ensued. The December measures thus continued the policy of monetary restraint which the Bank of Finland had pursued with increasing determination during 1980. Primarily domestic stability, but also external considerations, had necessitated this stance. 2/

During the first quarter of 1981, the current account showed a marked improvement and the foreign exchange position of the Bank of Finland strengthened sharply (Table 15). The inflow of foreign exchange, combined with increasing restraint in banks' lending activities, resulted in a decline in the average interest cost of banks as they reduced their borrowing in high-cost credit tranches from the central bank. At the same time, the Bank of Finland started a cautious policy of monetary easing by reducing the call money rate 3/ from 12.5 per cent in February 1981 to an average of 11.7 per cent in March and 10.6 per cent in April. This change in the direction of monetary policy

1/ Compare Table 17 and Chart 6. Persistent borrowing by banks within the second call money tranche (first supplementary charge tranche) continued until February 1981, and the Bank of Finland kept the call money rate stable at 12.5 per cent. Subsequently, banks' borrowing again fell into the first call money tranche and the average cost of borrowing dropped below the call money rate.

2/ In a move to increase the efficiency of the supply and use of cash, the Bank of Finland had introduced, effective November 21, 1980, the "till money credit," which eliminates banks' need to minimize their overnight holdings of cash in an attempt to reduce the cost of net borrowing from the central bank. This measure has resulted in a break in the series of cash holdings of banks.

3/ Since January 1, 1981, a formal link has been prescribed by the Bank Supervisors between the rate on call money and the discount rate. The upper limit for the call money rate is to be not higher than 15 percentage points above the discount rate; the lower limit is to be the discount rate itself.

was brought about by the anticipated weakening of domestic economic activity, and appeared to be justified in the light of the unexpectedly strong improvement in the current account. The policy of moderate monetary relaxation was pursued between April and June 1981 in the form of a stepwise reduction of the cash deposit ratio from its highest level of 4.6 per cent in December 1980-March 1981 to its present level of 3 per cent (Table 16). This measure released an average of Fmk 739 million during the second quarter of 1981, compared with the first quarter (Table 15). Given high interest rates abroad, no further interest rate measures were taken at first. The discount rate was left unchanged at 9.25 per cent, and the interest rate on call money was kept at 11 per cent between May and July. The average interest cost of bank borrowing from the central bank fell in line with a continuous reduction in banks' borrowing within high-cost credit tranches.^{1/} However, in August and September some moderately tightening policy measures were introduced in view of the development of domestic prices. Effective August 5, 1981, the call money rate was officially raised to 11 1/2 per cent and, effective September 1, 1981, the multiples of quota for the call money tranches were reduced from 5 and 8 to 4 and 7, respectively, a measure which was aimed primarily at those banks which tended to fund a large part of their lending out of resources borrowed from the central bank. The supplementary charges were left unchanged, at 4 per cent for borrowing between 4 and 7 times quota, and 10 per cent above 7 times quota.

Given the sharp decline in credit demand and a further sizable increase in net foreign assets of the central bank, monetary conditions eased considerably during the third quarter of 1981, and banks continued to reduce their call money indebtedness to the Bank of Finland (Table 15 and Chart 9). The average cost of borrowing fell below the call money rate, approaching the average lending rate of banks. However, reflecting the interest rate and quota measures mentioned above, borrowing costs rose in September and October (Table 17 and Chart 6).

b. Selective measures and guidelines

In April 1979, the Bank of Finland informed the banks that, in its view, too high a percentage of financial resources was tied up in longer-term mortgage and consumer credit. Since this was likely to impinge on the flexible financing of needed investment, particularly in the case of an upswing in the economy, banks were advised to reconsider their lending policy. In November 1979, when the economic upturn was in full swing, the Bank of Finland issued new credit policy guidelines to the banking institutions in which it described the future situation in financial markets as one of considerable tightness. Banks were therefore advised to be more selective in their evaluation of credit applications. Also, to enhance the competitiveness of the Finnish economy, banks were encouraged to give priority to profitable industrial and energy-saving investments. Consumer and housing loans were discouraged,

^{1/} The average lending rate of commercial banks remained essentially unchanged at 9.85 per cent. Given an inflation rate of about 13 per cent, real borrowing costs thus continued to be negative (Chart 6).

the latter on account of the overheating in the construction industry. Banks were also invited to exercise an influence on the timing of investments, so that the implementation of projects would fall into the second half of 1980 and into 1981, when a downturn in economic activity was expected.

In March 1980, the Bank of Finland strengthened its credit policy guidelines by ordering banks to keep the growth of housing and consumer credit below the average growth of credit. It also urged postponement of investment project financing into 1981. In October 1980, the Bank of Finland instructed monetary institutions to stop the financing of those construction projects which would become subject to special investment taxes on November 3, 1980 and had not yet been started. Finally, observing the still extremely buoyant growth of banks' lending to the private sector, the Bank of Finland announced in November that it intended to tighten monetary policy further. All banks were therefore advised not to increase their borrowing from the central bank in 1981, and those banks which had made most extensive use of this source of finance were instructed to reduce their central bank borrowing. Instructions were also given to prevent these guidelines from being circumvented through increased foreign borrowing. New credits were to be granted primarily for profitable and productive investment projects.

The use of other policy instruments, such as countercyclical deposits, export levies, 1/ sales of certificates of deposit, and modifications in the investment deposit scheme, all reflected the continued concern of the authorities about the high degree of volatility of liquidity and its implications for the stability of the economy. Their application was thus strictly countercyclical. In January 1979, the Investment Fund Law 2/ was replaced by the Investment Reserves Act, which offered more favorable financial and other conditions to individuals and corporations for building up investment reserves out of profits. The new law thus further encouraged them to deposit, during economic upturns, funds intended for investment, and to withdraw them during downturns. In December 1979, the Bank of Finland raised the interest rate on investment deposits made between November 15, 1979 and March 31, 1980, from 4 3/4 per cent--i.e. one half the discount rate--to 7 per cent, i.e. 1 1/2 percentage points below the discount rate. 3/ In April and October 1980, the investment reserve scheme was renewed and the percentage of profits eligible for transfer to investment reserves was increased from 50 to 70 per cent. The increased attractiveness of such reserves and the success of the policy were reflected in a fairly steady

1/ For a note on countercyclical deposits and export levies, see footnote 2 on page 29.

2/ Like the new Investment Reserves Act, the intention of the Investment Fund Law was to bring about a more even distribution, over time, of investment spending.

3/ The interest rate applies to that half of the amount of firms' investment reserves which has to be transferred to the Bank of Finland through a blocked account. Interest earnings from investment deposits are tax-exempt. The interest rate for deposits made before November 15, 1979, remained at the minimum rate stipulated by the law of one half the discount rate.

growth of investment deposits from end-1979 to end-1980. The growth continued during 1981, notwithstanding a dampening in economic activity. Countercyclical deposits out of profits and export proceeds 1/ were used particularly in 1980 to absorb excess liquidity in selected sectors of the economy. In May 1980, the sawn timber and chemical pulp industries were obliged to make export deposits. 2/ Effective October 1980, countercyclical deposits became compulsory for enterprises, with an envisaged duration of 12 months. 3/ A release of the funds from all of these deposits is scheduled to occur between the fall of 1981 and the spring of 1983.

Transactions in certificates of deposit of the central bank were carried out primarily with the government. For the larger part of 1979 and in early 1980, they exercised a contractionary effect on the overall liquidity of the economy. However, from the second half of 1980 and particularly during the first half of 1981, they were strongly expansionary. The interest rate on certificates of deposit was generally raised in line with the discount rate. Capital import deposits remained in operation throughout the period under investigation.

Central bank lending under the special financial arrangements continued to rise in importance and was essentially unaffected by the changes in the stance of monetary policy.

3. Development of the main monetary aggregates

The development of reserve money 4/ since 1979 (Table 18 and Chart 10) has been largely dominated by the imposition, effective May 1979, of cash reserve deposit requirements. Until the first quarter of 1981, reserve ratios were continuously raised (Table 16) and the growth rates of reserve money increased sharply, exceeding annual rates of 50 per cent between the fourth quarter of 1979 and the second quarter of 1980. After the first quarter of 1981, the cash reserve deposit ratio was lowered and the growth of reserve money fell markedly. The modest increase registered in the second quarter reflected the growth of currency in circulation and increases in reserve requirements due to the growth of the deposit base.

Throughout 1979, narrow money (M1) grew at an increasingly rapid pace. Growth stabilized during the first quarter of 1980, but subsequently dropped off sharply through early 1981. This development primarily reflected the behavior of demand deposits, while currency outside banks displayed a less

1/ In its present form, the export deposit law dates back to July 1979, but was only made operative in May 1980.

2/ See also p.17. Deposits amounted to 3-4 per cent of export earnings. They were to be repaid within three years and to earn an interest rate of 3 percentage points below the discount rate, but not less than 5 per cent.

3/ Deposits, equal to 5 per cent of firms' income liable to local income taxation, were to be repaid within three years of the collection date, and to earn a tax-free interest rate of 3 per cent.

4/ IFS definition. See footnote 3, p.27.

volatile growth pattern. The velocity of circulation of M1 showed no clear pattern or direction; its end-1980 level was about as high as the level observed in early 1975 (Chart 11). Broad money (M3), defined as M1 plus quasi-money primarily in the form of time and savings deposits, displayed a more even growth than M1. Its velocity of circulation fluctuated somewhat less and showed a clear downward trend from 1975 onwards. The relatively greater stability of M3 compared with M1 is believed to reflect shifts in the distribution of financial resources between the corporate sector, which is the prime holder of demand deposits, and the household sector. The greater stability of M3 may also point to an increase in the relative attractiveness, financial and other, of time and savings deposit accounts.

Total bank deposits grew at a rate of 15.7 per cent in both 1979 and 1980, compared with 14.6 per cent in 1978. This development clearly reflected the marked increase in income over this time span. However, casual evidence covering the period 1975-80 suggests that depositing behavior was also positively and stably influenced by the development of real deposit rates. ^{1/}

In 1979, the growth of credit to the private sector picked up sharply with the economic recovery (13.5 per cent), and its growth accelerated in 1980 (19.4 per cent). This development reflected primarily the vigorous investment climate during these two years. The growth of credit by the Bank of Finland to the private nonbank sector was particularly buoyant in 1980 as it grew at a rate of 33.7 per cent. Most of this credit was granted under the special financing arrangements referred to above. The growth of the Bank of Finland's short-term export credits to firms, granted to refinance their lending to customers, was exceptionally strong, reflecting the increasing differential between domestic and foreign interest rates during the latter half of the year. The growth of credits by deposit money banks attained the rate of 19.1 per cent in 1980, compared with 13.7 per cent a year earlier. Credit growth decelerated sharply in the first quarter of the year (14.9 per cent), reflecting both the decline in private investment activity and increased caution in lending. Some slight pickup was experienced in the second quarter (to 16.5 per cent) with the easing of monetary conditions.

^{1/} A first impression can be gained from a look at Charts 6 and 7. Quantitative evidence is provided by a regression of quarterly data for 1975-80 of real total bank deposits against real national income and the real average deposit rate (defined as the nominal rate minus the year-over-year change in the consumer price index). This regression suggests that an increase in the real average deposit rate by 1 percentage point will generate an increase in the real demand for deposits of Fmk 3.7 million. The coefficient has a t-statistics value of 5.4 and a t-probability of 1.

IV. Balance of Payments

1. Background

During the first half of the 1970s, the current account balance of Finland moved into heavy deficit, which peaked in 1975 at Fmk 8 billion (8 per cent of GDP). This deficit was partly attributable to the exceptionally rapid growth of domestic demand in Finland by comparison with partner countries (Chart 12) but also in part to a loss of price competitiveness. Realizing that an external imbalance of such magnitude was unsustainable, the Finnish authorities undertook a major reorientation of economic policies, which included, inter alia, the pursuit of restrictive domestic policies and several depreciations of the Finnish markka, totaling 16 per cent in effective terms during 1977 and 1978. The current account balance strengthened markedly on account of the change in Finland's cyclical position and of the improvement in competitiveness, which coincided with a pickup in the main foreign markets for Finnish export products. For the first time since 1969, the current account registered a surplus in 1978 (Fmk 2 1/2 billion, or 2 per cent of GDP). However, the balance deteriorated again in 1979 to a deficit of Fmk 3/4 billion, and especially in 1980, when a deficit of Fmk 5 billion (3 per cent of GDP) was registered (Tables 19 and 20).

The large swing in the current account between 1978 and 1980 was mainly the result of cyclical factors, as Finland accounted for the highest growth rate of real GDP among industrial countries in that period. In addition, a deterioration in the terms of trade amounting to 7 per cent over this period contributed to the worsening of the trade balance. This deterioration in the terms of trade contrasts with the virtual stability experienced just after the first oil price shock, when export prices of some basic products--e.g. forestry products, which make up a large proportion of Finland's exports--followed the upward price trend of oil products.

The surge in the trade deficit between 1978 and 1980 was mitigated, to some extent, by other factors. Depreciations of the Finnish markka and the rapid growth of productivity had resulted in an improvement in the competitive position of Finland from 1976 to 1978, which probably continued to have a lagged effect in 1979 and 1980. Further, the bilateral trade arrangement with the U.S.S.R., which provides two-thirds of Finland's imports of oil and oil products, facilitated a rapid external adjustment to the increase in oil prices. The trade between the two countries is regulated by five-year frame agreements, which stipulate rough balance in bilateral payments, at least in the medium-term, but the growth of exports tends to be more heavily concentrated in the first years of the agreement. The rise in import prices for oil and oil products resulted in a new trade protocol, signed in April 1980, covering additional export orders for an amount of almost Fmk 2 billion in order to balance the bilateral accounts. As a consequence, the deterioration in the terms of trade resulting from the rise in oil prices did not necessarily lead--except in the very short term--to a large deterioration in the trade balance, as it triggered an increase in the volume of exports to the U.S.S.R. Moreover, no significant supply constraints were experienced, which suggests that the rise in exports to the U.S.S.R. did not limit the availability of

exports for the Western markets. Hence, although the rise in oil prices has certainly adversely affected real national income, Finland has been in a more favorable position than most other oil-importing countries to avoid much of the deflationary impact on the economy resulting from the rise in oil prices.

The favorable development of exports to the U.S.S.R. continued in 1981 and made up for the shortfall in demand from the West. Coupled with the concomitant downturn in activity in Finland, which led to a decrease in imports in volume terms, the current account deficit is projected by the national authorities to decline to Fmk 3 billion in 1981 (1 1/2 per cent of GDP). For the first three quarters of 1981, only a deficit of Fmk 1.4 billion (not seasonally adjusted) was registered, but oil imports were expected to pick up in the fourth quarter of the year.

2. Merchandise trade

a. Exports

In 1980, the value of exports increased by 22 per cent to Fmk 53 billion against 23 per cent in 1979 (Table 21). Buttressed by an improvement in competitiveness and slow domestic demand growth, exports expanded rapidly in the second half of the 1970s. The share of exports in GDP increased from 20 per cent in 1975 to 28 per cent in 1980, as export volume expanded by 10 1/2 per cent per annum over that period. Exports of goods and services contributed on average 3 per cent per annum to the growth in GDP. In 1980 exports of merchandise rose by 9 1/2 per cent in volume terms, which was almost unchanged from 1979. Export prices increased by 11 1/2 per cent against 12 1/2 per cent in 1979, with the strongest rise registered for processed forestry products and chemicals following the movement in international prices, while export prices for metals and machinery rose by less than the average.

Whereas total exports increased at about the same rate in 1980 as in 1979, the market composition of export growth was completely different (Tables 21 and 22). In 1979, exports to the market economies increased by 30 per cent, while exports to the state trading economies actually decreased by 2 per cent in value terms. In 1980, however, exports to the market economies recorded an increase of 16 per cent in value terms, against 50 per cent for the state trading economies. The bipartite structure of Finnish trade thus permitted Finland to insulate itself in large part from the cyclical downturn in the industrial countries. The slowdown in economic activity in the market economies was the main reason for the deceleration in exports to these countries in 1980. Finland was particularly exposed to declining export demand, as its Western partner countries--notably the Scandinavian countries and the United Kingdom--experienced a stronger cyclical downturn than industrial countries on average. Real GNP rose by only 1 per cent in 1980 in Finland's partner countries. Exports to the oil-exporting countries expanded vigorously, albeit from a low level, and their export share still accounted for only 4 per cent of total exports in 1980.

Finnish exports have traditionally been heavily concentrated on basic goods such as forestry products (wood, pulp, paper, and paperboard) which, in 1980, made up almost 40 per cent of total exports (Tables 23 and 24). The reliance on products which are particularly sensitive to changes in economic activity and often subject to speculative price movements, has often exacerbated the effect of cyclical fluctuations abroad. As the reverse effects are not fully offsetting over the course of the business cycle, the total impact of the commodity structure has been negative in the longer run. A certain diversification of exports, both in the form of new products and also the refinement of existing products, took place in the 1970s, alleviating the negative impact of the commodity structure. According to recent estimates ^{1/} based on a constant market share analysis, the adverse impact of the commodity structure on Finnish exports has declined modestly from, on average, 1.7 percentage points in the 1960s to, on average, 1.1 percentage points in the 1970s. The last year when the commodity structure exerted a strong impact was 1975, when it is estimated to have contributed to a decrease in exports by 9.4 percentage points.

In 1980, a strong export performance went hand-in-hand with vigorous domestic demand, which, in certain sectors, led to nearly full capacity utilization. In the wood products industries, the level reached 93 per cent. The international raw material boom boosted export volume and the prices of forestry products in the first half of 1980, but a clear leveling off of foreign demand was noticeable toward the end of the year in line with the downturn in economic activity in industrial countries. The pick-up in exports to the U.S.S.R. in the second half of 1980 shifted the composition of exports from forestry products toward engineering products, textiles, and clothing. In some instances, domestic demand pressure might have limited or postponed exports, e.g. in the metal sector, which only showed a modest increase in export volume in 1980. Exports of chemicals expanded by 36 per cent in volume terms, partly because these products were included with a relatively large weight in the supplementary trade agreement with the U.S.S.R., and also on account of a surge in exports of refined oil products to Sweden. Although orders to Finnish shipyards went up in 1980, actual exports declined due to long production time.

In the first ten months of 1981, exports were 16 per cent higher in value terms than a year earlier. The growth in exports was almost solely attributed to a surge in exports to the U.S.S.R. (79 per cent). Exports of metal and engineering products, textiles, and clothing were particularly buoyant, both in volume and in value terms, as a consequence of the lagged effect of the supplementary trade agreement of 1980. However, exports of wood industry products, which are primarily dependent on demand in OECD countries, declined in volume terms as a result of sluggish economic activity--especially in

^{1/} Bank of Finland, "Finnish Export Performance in Western Markets," Monthly Bulletin, May 1981. The adverse impact represents the difference between the rate of growth of world exports with commodity classes weighted according to the commodity composition of Finnish trade and the growth of world exports on an unweighted basis.

construction--in these countries. No significant decline in volume terms was yet visible for paper and graphic products. For the year as a whole, the Finnish authorities forecast a volume increase of exports of 2 per cent, which is the combined result of a decrease in exports to the West of 4 per cent and an increase in exports to the East of 28 per cent.

b. Imports

In 1980, imports grew by 32 per cent in nominal terms to Fmk 58 billion (Table 25). The increase was distributed between a volume increase of 12 per cent and a price increase of 17 per cent. Notwithstanding a decline in domestic energy consumption and replenishment of oil inventories in 1979, real imports of crude oil remained at the same level in 1980. However, this is explained by the relatively strong rise in exports of refined oil products mentioned above. Brisk domestic investment demand was responsible for a substantial increase in imports of investment goods (31 per cent in volume terms), particularly for the metals industry. But the level--in volume terms--of imported investment goods was nevertheless 16 per cent lower than the previous peak in 1975. Investment in machinery and equipment was 8 per cent lower, which suggests that a larger share of investment goods is now provided by domestic rather than by foreign suppliers. An improvement in real disposable income of private households also led to higher imports of consumer goods (16 per cent). The import elasticity with respect to real GDP amounted to 2.6, which was about the same as in 1979. Imports plunged in the fourth quarter of 1980, measured on a seasonally adjusted basis, to a level which was almost the same as a year earlier. The drop in imports was particularly noticeable for raw materials and production supplies, caused partly by shortfalls in scheduled oil and coal delivery and partly by a turnaround in domestic stock-building.

Imports from the state trading economies have accounted for a steadily increasing share of imports following the rise in oil prices. In 1980, imports from these countries rose by 40 per cent in nominal terms, which was about the same increase as in 1979, and imports from these countries made up one fourth of total imports. The import bill for oil and oil products--from state trading and other economies--increased by Fmk 5 billion in 1980, equivalent to one third of the total rise in imports.

The demand for investment and consumer goods noted above was mainly satisfied through imports from the Western market economies. While the growth of imports from EC and EFTA countries in 1979 had been about equal, imports rose about twice as much (in value terms) from EC countries as from EFTA countries in 1980.

During the first half of 1981, imports in volume terms were down by 6 per cent compared to the same period in 1980. However, a simultaneous sharp rise in import prices, especially for energy products, resulted in an increase of 6 per cent in nominal terms. The most significant downturn, in volume terms, was registered for raw materials and producer goods, which plummeted by 10 per cent. This drop may reflect unusually strong destocking, caused by higher financing costs and general uncertainty about economic

prospects. The deceleration in economic activity in Finland explained the overall declining trend in import volume, although imports seem to have responded more sharply than expected. Imports of consumer goods dropped by 1 1/2 per cent in volume terms in the first half of 1981, despite an increase in private consumption of 1 1/2 per cent over the same period. Notwithstanding the fact that investment in machinery and equipment rose by only 1 1/2 per cent in real terms in the first half of 1981, imports of investment goods still increased by 16 per cent.

For 1981 as a whole, the Ministry of Finance forecasts a decrease in imports in volume terms by 5 per cent and an increase in import prices by 13 per cent. Imports of raw materials and other production input will drop significantly as a result of weakened growth prospects in industry. Imports of crude oil may fall by as much as 15 per cent, since the domestic demand for petroleum products as well as exports of these products are decreasing. The mild winter of 1980-81 and the ongoing process of replacing oil with other heating systems are part of the explanation. Imports of investment goods may grow slightly for 1981 as a whole, although no increase will take place in the second half of the year. Imports of consumer goods will remain flat at the peak level attained in 1980, which is in line with the development of private consumption.

c. Competitiveness

In the late 1960s, Finland's international competitiveness improved, following favorable cost developments and a major devaluation of the Finnish markka in 1967. This tendency continued until 1973, when production costs in Finland started rising faster than in trading partners. At first, a simultaneous spurt in export prices arrested a decline in profitability in the export sector. Later, however, profit margins also dropped. During the period 1973-76, a significant deterioration in competitiveness took place, which, however, was largely redressed in the years 1977-78. In the latter period, relative unit labor cost in national currencies declined by 5 per cent. When adjusted for exchange rate changes, the decrease was as much as 18 per cent (Table 26). In 1979 and 1980 relative unit labor costs, adjusted for exchange rate movements, were practically unchanged (Chart 13). In 1981, however, unit labor costs have increased by more than in partner countries, and relative unit labor costs may increase by 4 per cent. Comparing the sheltered and the open sectors, unit labor costs seems to have risen less rapidly in the open sector in 1981, as a consequence of a larger rise in productivity. This would imply less deterioration in competitiveness to the extent that the same difference between the two sectors does not exist in other countries.

The development of export prices relative to domestic unit labor costs, which is an indicator of profitability in the export sector, roughly showed that profitability increased from 1976 to 1980. In 1981, profitability was probably unchanged.

The analysis of market shares for individual products sheds additional light on the development of competitiveness, as it also reflects nonprice factors. This type of analysis is especially important for a country like

Finland, which is dependent on exports of a limited number of products that are often subject to volatile demand. As Table 24 indicates, market shares for paper and paperboard products were roughly maintained from 1976 to 1979. For wood and pulp products, a strong increase in market shares took place. The Finnish authorities estimate that the market shares in the Western economies for the main export products have been preserved in 1980 and 1981. Even during the mid-1970s, when cost-competitiveness deteriorated, the loss in market share was barely evident except for pulp products. This suggests either that a drop in profit margins took place or that nonprice factors were important. One such factor for forestry products might have been the increased efforts of Finnish companies relative to foreign firms to integrate the production lines of basic forestry products and pulp and paper. To the extent that this development results in a rise in productivity, unit labor cost calculations capture this effect. However, in addition, there might be advantages in terms of transportation costs, management skills, etc.

3. Balance on services and transfers

The surplus on the services balance, which amounted to Fmk 0.7 billion in 1980 (Table 19), was almost unchanged from 1979. Net transportation earnings of Fmk 3 billion remained at the same high level that was reached in 1979, when the surplus soared by 49 per cent in nominal terms. But, despite a further boost to Finnish exports, no additional increment was registered in 1980 as a consequence of a lengthy maritime strike in the second quarter of 1980 and a decline in freight rates. Exports of know-how, which developed from almost nothing at the beginning of the 1970s to a level of Fmk 1.6 billion in 1980, continued to expand, particularly project exports for the U.S.S.R. and the Middle Eastern countries. The deficit on net investment income widened only by Fmk 0.5 billion to Fmk 3.3 billion, notwithstanding a substantial surge in international interest rates. This is partly explained by the fact that a significant share of foreign trade is financed with interest-free trade credits received from state trading countries. In addition, a large proportion of the foreign debt bears fixed interest rates.

The transportation balance improved by Fmk 0.6 billion in the first half of 1981, compared to the same period of 1980, partly as a result of the poor performance in 1980 mentioned above. The surplus of other services, mainly know-how exports, evaporated because of difficulties in the Middle East and because of the fact that payments from the U.S.S.R. are concentrated in the second half of 1981.

4. Capital transactions, foreign debt, and assets

Following a net inflow of total nonmonetary capital, including errors and omissions, of Fmk 1.5 billion in 1978, accompanying a current account surplus of Fmk 2.6 billion, the net inflow decreased slightly to Fmk 1.4 billion in 1979 (Table 19). In 1980, the inflow of nonmonetary capital, which totaled Fmk 6.3 billion, exceeded the current account deficit of Fmk 5.2 billion. The composition of net capital inflows changed substantially, as traditional net long-term capital inflows fell sharply in 1979 and almost vanished in 1980, being replaced by short-term inflows amounting to Fmk 0.5 billion in 1979

and as much as Fmk 5.5 billion in 1980. Errors and omissions registered a positive balance of Fmk 0.6 billion in 1980, after almost balancing in 1979. In the first half of 1981, net nonmonetary capital inflows amounted to Fmk 0.6 billion. For 1981 as a whole, long-term capital imports are expected to pick up to Fmk 3 1/2 billion, as the net outflow from the private sector rebounds to a sizable net inflow of long-term capital. Altogether, nonmonetary capital inflows are expected to amount to Fmk 5 1/4 billion, clearly surpassing the estimated current account deficit of Fmk 3 billion.

The net foreign debt of Finland, which amounted to Fmk 24.6 billion at the end of 1979 (15 1/4 per cent of GDP), rose to Fmk 29.2 billion (15 3/4 per cent of GDP) in 1980, and to Fmk 33.8 billion (16 per cent of GDP) at the end of June 1981, with the resurgence of the current account deficit.

a. Nonmonetary long-term capital

Total net long-term capital imports, which dropped from Fmk 3.7 billion in 1978 to Fmk 0.9 billion in 1979, declined further to a meager Fmk 0.2 billion in 1980. Net imports of long-term loans were undertaken by the Central Government through bond issues abroad and amounted to a net Fmk 1.6 billion in 1980, down from Fmk 2.2 billion in 1979 (Table 27). Net long-term capital outflows, however, were registered for the private sector. Although investment was quite buoyant and Finnish corporations traditionally finance a large share of their domestic investment through foreign borrowing, redemptions exceeded new loans in both 1979 and 1980, and net capital outflows from the corporate sector of Fmk 0.6 billion were registered in each year. Improvement in the profitability and the financial position of firms, as well as rising interest rates abroad and general uncertainty about exchange rate movements, were the main reasons for the reluctance of Finnish companies to take up new long-term credits abroad. Direct investments in both directions were of the same magnitude as the year before, accounting for an outflow of Fmk 0.4 billion on a net basis. Half of the net investment in Finland by foreign companies or by Finnish firms abroad was directed to manufacturing subsidiaries. At the end of 1980, about 900 firms in Finland had foreign ownership exceeding 20 per cent of their equity capital, which represented a doubling during the 1970s. On the other hand, subsidiaries of Finnish companies abroad had tripled in number over the same period to almost 1,100 firms in 1980.

During 1979 and 1980, the share of long-term financial loans carrying a variable rather than a fixed interest rate increased in line with the general development of international capital markets. About 46 per cent of outstanding long-term loans were denominated in U.S. dollars, 12 per cent in Swiss francs, 12 per cent in deutsche mark, and 7 per cent in yen. Imports of long-term capital picked up from mid-1981, and, for the year as a whole, they may amount to as much as Fmk 3.5 billion. This is mainly explained by a reversal in private capital flows from a net outflow of Fmk 1.3 billion in 1980 to a net inflow of about Fmk 1 1/2 billion in 1981.

b. Nonmonetary short-term capital

After net short-term capital imports of Fmk 0.5 billion in 1979, the net inflow expanded to Fmk 5.5 billion in 1980. Most of the capital imports financed the increase in merchandise imports. Thus the largest inflow was reached in the third quarter of 1980, when the trade deficit peaked. At the beginning of 1980, a rising trend in foreign interest rates which was not matched by an equal increase in domestic rates halted short-term capital imports. In May 1980, however, short-term capital inflows reacted to a temporary drop in foreign interest rates. Later in the year, when foreign interest rates began climbing, short-term capital inflows nonetheless continued due to the widening of the trade deficit, albeit at a much lower rate. About Fmk 1.2 billion of short-term capital inflows was related to exports in the form of prepayment for exports to the state trading economies, which is a common feature of the bilateral agreements. The bulk of export-related credits was arranged toward the end of the year.

In the first half of 1981, short-term capital imports amounted to Fmk 2.3 billion, or Fmk 1.2 billion less than in the same period a year earlier. This was caused by a decrease in import credit, compared to the year before, partly reflecting the rising spread between domestic and foreign interest rates. It is noticeable that the banks are not likely to account for any net short-term capital import in 1981, which compares to a net import of Fmk 4 billion in 1980. The net short-term inflow amounting to an expected Fmk 1 3/4 billion for 1981 as a whole is probably mostly associated with prepayment for exports to the East.

c. External debt

Total net foreign debt, ^{1/} which peaked in 1977 at 21 per cent of GDP (Fmk 27.1 billion), was subsequently reduced to 15 1/4 per cent of GDP in 1979 (Fmk 24.6 billion), in line with the improvement of the current account balance (Table 28). However, in 1980, net foreign debt surged again to Fmk 29.2 billion, equivalent to 15 3/4 per cent of GDP. For a comparison, net foreign debt amounted to 25 per cent of GDP in Denmark, 35 per cent of GDP in Norway, and 10 per cent of GDP in Sweden. The debt service payments on gross long-term debt dropped from Fmk 8 billion in 1979 to Fmk 7.4 billion in 1980. Repayments decreased as a consequence of a reduction in premature amortization payments, which had been particularly prevalent in 1979, when international credit terms were favorable, and, in addition, because of the lengthening of maturities that had taken place in connection with renegotiation of loans. On the other hand, interest rate payments on the debt subject to variable rates increased. Altogether, two thirds of the foreign borrowing carries variable interest rates. The weighted average interest rate on the stock of financial loans rose from 9.2 per cent in 1979 to 9.6 per cent in 1980. The debt service payments increased in 1981, following the sharp pickup in foreign interest rates.

^{1/} Excluding the equity proportion of direct investments and subscriptions to international financial institutions.

Net long-term debt, which makes up by far the bulk of total net foreign debt, amounted to Fmk 30 billion at the end of 1980. Gross long-term liabilities were up by Fmk 1 billion to Fmk 34.7 billion. No major change in the composition took place during 1980. Seen over a longer time-span, the share of bonds and debentures in gross long-term liabilities has increased from 35 per cent in 1977 to 44 per cent as a result of the rise in foreign borrowing by the Central Government (Table 29). The share of long-term import credits, however, decreased during the same period from 19 per cent to 12 per cent. Gross long-term assets, which are primarily made up of export credits, increased by Fmk 0.5 billion to Fmk 4.6 billion at the end of 1980.

Net short-term liabilities and assets were approximately equal by the end of 1980, with net short-term assets amounting to Fmk 0.8 billion. This represented an increase in net short-term debt of Fmk 4.2 billion during the year.

In the first half of 1981, net long-term debt increased by Fmk 2.5 billion and short-term debt by Fmk 1.3 billion. As the current account was in rough balance during this period, the increase in foreign debt was attributed to exchange rate developments, particularly the sharp rise in the value of the U.S. dollar, which is the currency of denomination for almost half of the long-term debt.

5. Foreign exchange reserves

Compared to other industrial countries the official foreign exchange reserves of Finland have traditionally been at a low level. This has been possible as a consequence of exchange and capital restrictions, and also because the Finnish markka has not been the focus of exchange rate speculation from abroad. In 1973, a reorientation of the reserves policy took place following the transition to floating exchange rates, larger fluctuations in the prices of traded goods, and a rundown in official reserves. In addition to relying on actual reserves, the Finnish authorities began entering into agreements with international banking consortia concerning credit lines, which boosted available liquidity. Since then, credit facilities have constituted a continuing supplement to actual reserves of the Bank of Finland. Among the advantages of credit lines is the diminished cost, as only a management fee and a commission fee on the total amount of the credit line are paid, in contrast to borrowed reserves, in which case the cost, in addition to the management fee, is the spread between the interest rate for borrowing and the return on deposits or placements of the reserves in the international capital market. Another important factor is the exchange rate risk, which is reduced to zero as long as the credit line is not tapped, but occurs for borrowed reserves to the extent that these reserves are invested in assets with a different currency composition from the borrowing denominations. In mid-1981, available credit lines amounted to \$1,500 million, a sum almost equal to the gross foreign exchange reserves of the Bank of Finland. The existing credit lines, which can be activated on short notice, were all concluded in 1980 and 1981 for a duration of 5-8 years, and have not yet been used.

Notwithstanding a sharp increase in the current account deficit in 1980 and negligible long-term capital imports, the reserves of the Bank of Finland increased by Fmk 1.1 billion in 1980, as short-term capital movements more than compensated for the deficit in the basic balance. The increase was Fmk 0.5 billion above the rise in official reserves in 1979. In 1980, the increase was primarily confined to convertible currencies.

According to the IFS definition (Table 30), gross official reserves increased by \$330 million (SDR 300 million) during 1980, to \$1.9 billion (SDR 1.5 billion) at the end of 1980. The reserve position in the Fund increased in connection with the entry into force of the seventh general quota review (and the foreign exchange holdings decreased concomitantly). At the end of 1980, total reserves equalled 13 per cent of imports in that year. At the same time, convertible reserves amounted to 18 per cent of Finland's Western imports.

In the first nine months of 1981, gross official reserves fell by \$0.4 billion to \$1.6 billion (SDR 1.4 billion), reflecting exchange rate changes.

6. Development aid

While the ratio of official development assistance (ODA) to GNP had been almost constant from 1975 to 1978, it rose to 0.21 per cent of GNP in 1979 as a result of an increase of almost 60 per cent in ODA (in U.S. dollar terms) (Table 31). In comparison to the other 17 member countries of the Development Assistance Committee (DAC), Finland moved up from sixteenth place in 1978 to thirteenth place in 1979. In addition, all outstanding credits and credit commitments to low-income less-developed countries were converted into grants in 1979 and, since then, aid to these countries has in principle taken the form of grants rather than loans. These steps were in line with the interim target announced in 1977 to increase aid appropriations to 0.32 of GNP in 1982. In June 1980, the Government declared its intention to reach the target of 0.7 per cent of GNP by the end of the decade. The appropriations for official development assistance amounted to \$106 million in 1980 (0.22 per cent of GNP) and \$149 million in 1981 (0.27 per cent of GNP). In 1982, the budget includes appropriations of \$167 million, which is expected to amount to the targeted 0.32 per cent of GNP.

With a grant element of ODA of 97 per cent in 1979, Finland ranks among the countries giving aid on the softest financial terms. Most development loans are tied to 80 per cent procurement in Finland.

In addition to official development aid, the volume of development assistance by Finnish private voluntary agencies has grown rapidly during the past few years. In 1978, total grant disbursements by private voluntary agencies amounted to \$6 million, increasing to \$10 million in 1979 and \$16 million in 1980.

V. Exchange and Trade System 1/

1. Exchange rate

The Bank of Finland quotes daily buying and selling rates for the U.S. dollar, the intervention currency; these rates are also applicable to clearing dollars. Buying and selling rates for the clearing ruble are based on the rates of the State Bank of the U.S.S.R. for the U.S. dollar against the ruble. Quotations for other currencies are based on market cross rates. The forward rates for convertible currencies are quoted by authorized banks, whereas the Bank of Finland quotes daily forward rates for the clearing ruble and concludes forward transactions for periods ranging from 1 to 12 months.

Since 1972 the Finnish authorities have moved gradually toward expressing the external value of the Finnish markka in terms of a trade-weighted basket of the currencies of Finland's most important trading partners. Effective November 1, 1977, the Currency Act was amended to express formally the external value of the markka in terms of the currency index of the Bank of Finland (1974 = 100). The index includes the currencies of those countries which have accounted for not less than 1 per cent of the total of Finland's commodity imports and exports in each of the last three calendar years. 2/ The index is expressed as the Finnish markka value of the currencies of partner countries. An increase (decrease) in the exchange rate index accordingly represents an effective depreciation (appreciation) of the markka. The margin for fluctuation, which was initially set at 4.5 per cent between the upper and lower limits, has been widened since September 21, 1979, to 6 per cent. As depicted in Chart 14, four different ranges for fluctuations have prevailed since November 1, 1977. At the end of October 1981, the upper fluctuation limit was 119.0 while the lower limit was 112.0. 3/

Following depreciations of the currencies of Sweden, Norway, and Denmark, 4/ the markka was depreciated by 5.7 per cent against the currency index on April 5, 1977, and by 3 per cent on September 1, 1977. On February 17, 1978, the markka was depreciated by a further 8 per cent against the index after a depreciation of the Norwegian krone by 8 per cent against the

1/ A survey of Finland's exchange and trade system as at end-December 1980 is contained in the Fund's Annual Report on Exchange Arrangements and Exchange Restrictions, 1981.

2/ In October 1981, 15 currencies were included in the currency index, and the weights of the major currencies included were 22 per cent for the U.S.S.R. ruble, 16.5 per cent for the Swedish krona, 13.2 per cent for the pound sterling, 13 per cent for the deutsche mark, and 9.9 per cent for the U.S. dollar.

3/ On November 1, 1977, the initial limits were set at 112.0 and 107.1. They were subsequently changed to 121.7 and 116.4 on February 17, 1978; to 121.0 and 114.0 on September 21, 1979; and to 119.0 and 112.0 on January 30, 1980.

4/ Finland's bilateral trade with Sweden, Norway and Denmark accounted for almost 30 per cent of total trade with OECD countries in 1980. In addition, Finland competes in third markets with exports from these countries.

other currencies of the European common margins arrangement. Altogether the effective depreciation of the Finnish markka--as measured by the currency index of the Bank of Finland--amounted to about 16 per cent from the beginning of 1977 to the end of 1978. In order to limit the impact of rising import and export prices on the domestic price level, the markka was appreciated by 1 per cent in May 1979, and by 2 per cent on September 21, 1979. With the same motivation, the external value of the markka was further raised by 2 per cent on March 25, 1980, cumulating to an appreciation of 5 per cent. This last appreciation was within the permitted margin of fluctuation for the currency index, which had been changed from 114-121 to 112-119 on January 30, 1980. Despite unrest and major fluctuations in the exchange rates of the major currencies during 1980, the exchange market for the markka was relatively calm in that year, and official interventions were of limited magnitude.

From January to December 1980, the effective rate of the Finnish markka appreciated by 2 per cent in terms of the currency index. According to the Fund's MERM effective rate, the markka appreciated by 2.8 per cent in 1980. 1/ This relatively small movement in effective terms covers a depreciation of the Finnish markka against the U.S. dollar and the pound sterling of 4.4 per cent and 7.7 per cent respectively, from average January to average December 1980. The bilateral movements vis-à-vis the Swedish and Norwegian kroner were negligible, while a major appreciation was realized in terms of the currencies of the European Monetary System (EMS). The markka thus appreciated by 9.4 per cent against the deutsche mark over the same period. During the first ten months of 1981, the currency index of the Bank of Finland remained unchanged, but the effective exchange rate as calculated by the Fund (MERM) showed a depreciation of 2 per cent. The discrepancy between the two indices reflects primarily the inclusion of the ruble in the official index, and the much larger weight for the U.S. dollar, which appreciated sharply during this period in the MERM index. 2/ On September 14, 1981, when the Swedish authorities decided to allow the Swedish krona to depreciate by 10 per cent in terms of their currency basket, the Finnish markka was left unchanged in terms of the currency index. However, this maintenance of an unchanged effective exchange rate implied an appreciation of the Finnish markka against the Swedish krona of about 8 per cent and a depreciation of 2 per cent against other currencies. The competitive position of Finnish industry as well as the general economic situation in Finland did not seem to call for a depreciation of the markka. No speculative pressures on the markka followed the Swedish move.

The Bank of Finland has traditionally played an important role in the forward exchange market, as the market among the commercial banks was rather undeveloped for a long time. The forward discount or premium quoted by the

1/ For calculations of the real effective rate, see Chapter IV, Section 2.c on competitiveness.

2/ In case of an appreciation of the U.S. dollar in terms of the Finnish markka that is not accompanied by an equal appreciation of the ruble against the markka, the MERM rate will tend to show a larger depreciation (or less appreciation) of the markka than the currency index.

Bank was based on interest rate differentials as well as other considerations. However, in 1979 and at the beginning of 1980, forward quotations reflected only interest rate differentials. As the private forward exchange market for U.S. dollars gradually expanded, the Bank of Finland decided to withdraw from this market under normal conditions, effective April 1, 1980, in line with the practice prevailing in most developed economies. Guidelines were issued to the banks concerning their open position, but no exact limits were laid down until December 1980. The restrictions on banks' borrowing abroad were also relaxed to permit foreign borrowing to cover open forward exchange positions. As the private market has no possibility of covering a forward position in rubles, the Bank of Finland continues to intervene in the forward market for the ruble. The experience with the new system has so far been satisfactory. The volume of transactions has been rising rapidly.

2. Exchange system

a. Prescription of currency and clearing agreements

Exchange controls are administered by the Bank of Finland. Settlements in respect of current transactions with countries other than those with which Finland has a bilateral payments agreement may be made in any convertible currency or through Convertible Accounts. Settlements with the bilateral countries--Bulgaria, the People's Republic of China, Czechoslovakia, the German Democratic Republic, Hungary, Mongolia, Poland, Romania, and the U.S.S.R.--must be made in the currency of the agreement: the clearing ruble for the U.S.S.R., ^{1/} the clearing Finnish markka for the People's Republic of China, and the clearing U.S. dollar in other cases.

The bilateral payments agreements differ from each other in terms of their practical application, but several distinguishing features can be discerned:

(1) The clearing system is applied in its "purest" form to the payment flows between Finland and the U.S.S.R. Under this arrangement, five-year and one-year agreements on the volume and types of goods to be exchanged provide a guideline to help attain a payments balance, and attempts are normally made to avoid exceeding the credit limits by expanding deliveries of goods to the required extent. Thus, though the balancing of clearing accounts in convertible currencies is possible, it has not been practised. The bilateral payments agreement with the German Democratic Republic has operated in a similar fashion, while there is no provision in the agreement with Bulgaria for balancing, other than by way of deliveries of goods. With effect from January 1, 1982, a new payments agreement with Bulgaria provides for outstanding balances to be settled in freely convertible currencies.

(2) The agreements with Hungary, Romania, and the People's Republic of China entail a more flexible clearing system, in the sense that the outstanding balances under the agreements are settled in convertible currencies.

^{1/} Prior to April 1, 1978, the clearing ruble was also used in settlements with Romania.

In general, outstanding balances under the agreements have been allowed to exceed the formal credit limits, sometimes substantially, and in most cases there have also been deliveries against payment in freely convertible currencies. On October 30, 1981, a new agreement with Romania was signed which, from January 1, 1982, would make the bilateral payments arrangement compatible with the Fund's Articles of Agreement concerning exchange restrictions. Negotiations are taking place with the People's Republic of China for a new agreement, which will also terminate payments restrictions.

(3) Clearing agreements have remained in force in the case of Czechoslovakia and Poland but, since 1970, payments have been effected in convertible U.S. dollars.

From 1975 to the third quarter of 1979, Finland was in a net creditor position under its bilateral payments agreements. However, the situation changed with the rise in oil prices, and Finland moved into a sizable net debtor position (particularly with the U.S.S.R.). Its deficit with the U.S.S.R. peaked in June 1980, but has gradually diminished since the pick-up in exports to the U.S.S.R. in the second half of 1980.

b. Nonresident accounts

There are three categories of nonresident accounts: convertible, restricted, and capital. Convertible Accounts are held in Finnish markkaa or in other convertible currencies, and balances may be transferred abroad freely to any country. Restricted Accounts are held by residents of countries with which Finland has bilateral payments agreements, and they may be held in Finnish markkaa or in the currency of the country of residence. Balances in these accounts may be transferred freely to the bilateral country concerned. Capital Accounts, which are held in Finnish markkaa, comprise all other nonresident accounts: their assignment to other nonresidents or the transfer abroad of funds held in such accounts may, apart from minor exceptions, be effected only with the permission of the Bank of Finland.

c. Payments for imports

Foreign exchange is sold by authorized banks for payment for all permitted imports. Payment must be made within 12 months after customs clearance. If the period of suppliers' credits exceeds six months, unless specially authorized by the Bank of Finland, the credit is subject to an "overtime fee" set on an ad hoc basis and payable to the Bank of Finland; if the payment is made to the seller by using an import financing credit, the credit period may not exceed three months.

d. Export proceeds

Exporters are required to repatriate their foreign exchange proceeds within eight days of collection. They need not surrender the proceeds to the Bank of Finland or to an authorized exchange dealer, but can keep them in a foreign currency account with domestic banks.

e. Invisibles

With few exceptions, residents are permitted to effect payments for most invisibles. A Finnish resident traveling abroad may purchase, in principle, foreign exchange equivalent to Fmk 5,000 per trip from commercial banks. Foreign exchange receipts from invisibles must be repatriated within eight days of collection.

f. Capital

The inflow of direct investment capital must be approved by the Bank of Finland. The Bank grants permission liberally, unless the investment is judged to be exceptionally detrimental to the national interest or to be of a purely financial character. Repatriation of approved direct investments is subject to verification by the Bank of Finland. Foreign investments involving participation of more than 20 per cent in the share capital of an enterprise require approval by the Council of State, which is usually granted. Direct foreign investment in the forest and mining industries and in certain traditionally regulated activities is not normally permitted. As regards portfolio investment, nonresidents may purchase bonds, debentures, or shares quoted on the Helsinki Stock Exchange through an authorized bank against convertible currencies, or by debiting a Convertible Account. Approval is freely given for the export of securities purchased in this way, and proceeds from the sale of such securities may be repatriated. The acquisition by nonresidents of Finnish shares, bonds, and debentures through the debiting of a Capital Account is also permitted automatically, but proceeds from their sale may not be transferred abroad without the permission of the Bank of Finland.

Most transfers of capital abroad by residents require approval by the Bank of Finland. Investment by residents in foreign securities is rarely permitted. Authorized banks, however, are given permission to purchase specified foreign and Finnish securities issued abroad. Purchases of real estate abroad are authorized up to a limit of Fmk 175,000, subject to the Bank of Finland's approval, which is liberally granted. Direct investment abroad is approved on the merits of each case. Since August 1981, only verification by the Bank of Finland has been needed for direct investment in foreign sales subsidiaries not exceeding Fmk 1 million per year.

Foreign currency borrowing by Finnish residents, in the form of short-term or medium-term financial credits or of bond issues abroad, requires the specific approval of the Bank of Finland, which exercises surveillance over the terms and timing. Lending to nonresidents is normally restricted to export credits. No permission is needed for customary export credits. A selective deposit requirement is applied to medium-term and long-term borrowing abroad, other than borrowing by the State or for purposes of financing imports, when the financial needs are considered to lag behind the actual loan proceeds. The terms are set on an ad hoc basis by the Bank of Finland.

3. Trade system and commercial policy

Most goods may be imported free of license from the multilateral area. However, certain goods may be imported under a global quota system. The total value of global quotas for 1980 was 0.6 per cent of total imports. The only commodities still subject to quantitative restriction from the multilateral area are certain agricultural commodities, and fuels and petroleum products.

Import licenses are not required for most commodities originating in and shipped from the U.S.S.R. or the five countries with which agreements have been concluded on the reciprocal removal of obstacles to trade (Bulgaria, Czechoslovakia, the German Democratic Republic, Hungary, and Poland).

Export licences are required only for exports of scrap metal. Exports of raw timber and some commodities in the agricultural sector, as well as exports to countries not in the convertible area, require an export control declaration which, except in a few specified cases, is approved automatically by the Export and Import Permits Office.

4. Changes in the exchange and trade system since January 1, 1979

1979

January 24. An agreement was signed with Malaysia for the voluntary restraint by Malaysia of exports of men's and boys' shirts to Finland during the period March 1, 1979 to December 31, 1981.

March 1. The cash payment scheme for imports was abolished.

March 1. The maximum amount of foreign exchange permitted to be taken out of the country by residents without the approval of the Bank of Finland was raised from the equivalent of Fmk 3,000 to Fmk 5,000 per person per trip. The commercial banks' latitude for discretion in selling foreign exchange for business trips was increased.

April 26. Finland informed the CONTRACTING PARTIES of the GATT that it had ceased to invoke the provisions of Article XII of the General Agreements as justification for the application of quantitative restrictions on imports.

September 1. Residents were permitted to buy real estate abroad up to a limit of Fmk 150,000. The purchases are subject to approval by the Bank of Finland, which is liberally granted.

September 21. The external value of the markka was appreciated by 2 per cent in terms of the currency index of the Bank of Finland. The fluctuation limits of the currency index were fixed at 121.0 and 114.0, implying a widening of the margin to 6 per cent.

September 25. Finland and the U.S.S.R. signed a framework agreement for bilateral trade for 1981-85, which allows for an increase in trade by 40 per

cent over the level of the current framework agreement. About two thirds of Finnish imports under the agreement represent energy products, with the U.S.S.R. raising crude oil exports to Finland to 7.5-8 million tons a year from the 7 million tons envisaged in the bilateral trade agreement for 1980.

September 25. Finland accepted the obligations of Article VIII, Sections 2, 3, and 4, of the Fund's Articles of Agreement.

December 4. Finland and the U.S.S.R. signed the bilateral trade agreement for 1980. The exports and imports listed in the protocol are estimated to total some Fmk 18 billion, representing an increase of approximately 20 per cent over 1979.

1980

January 1. The minimum import prices set by the Ministry of Finance for certain clothing items were extended for the calendar year 1980.

January 1. Import licensing for a number of goods was relaxed.

January 11. The trade and payments restrictions applying to Zimbabwe were lifted.

January 30. The Government allowed the Bank of Finland to lower the range of fluctuation for its currency index from 114-121 to 112-119.

March 19. The Bank of Finland concluded an agreement on a credit facility of US\$150 million with an international group of banks.

March 25. The markka was revalued by 2 per cent in effective terms. The revaluation was within the range of the currency index set by the Government, and the range was not affected.

April 1. The Bank of Finland discontinued the quotation of forward rates for the U.S. dollar. New guidelines for the forward market were also issued for commercial banks.

April 30. The Bank of Finland concluded an agreement on a credit facility of US\$200 million with an international banking consortium.

June 1. In accordance with decisions taken by the Government on May 23, 1980, a 4 per cent export deposit requirement was imposed on sawn timber, and a 3 per cent export deposit requirement on bleached sulphate cellulose. These deposits were to be collected for a period of 12 months.

July 1. Temporary individual import licences for certain electrical and mechanical goods were abolished. The EFTA agreement between Finland and Spain entered into force.

July 16. The Bank of Finland concluded a credit facility agreement for US\$600 million with an international banking consortium. This facility will

be in force for 8 years, and replaces the two agreements concluded with the same consortium in 1976 and 1979, respectively.

1981

January 5. The Bank of Finland set a specific quota on commercial banks' lending to importers.

February 12. The Bank of Finland signed a credit facility agreement amounting to US\$150 million with an international banking consortium.

March 1. The export deposit requirement on bleached sulphate cellulose was abolished.

March 23. Residents were permitted to buy real estate abroad up to a limit of Fmk 175,000.

April 6. The export deposit requirement on sawn timber was abolished.

May 13. It was announced that export deposits collected during the period June 1, 1980 to April 6, 1981 would be repaid in one instalment in January-February 1982.

September 1. The Bank of Finland issued new guidelines to other banks dealing in foreign exchange concerning forward markets in foreign exchange in order to improve the opportunities for firms to protect themselves against foreign exchange risks.

October 30. A bilateral trade agreement with Romania was signed, which would terminate payments restrictions with effect from January 1, 1982.

Energy

1. Energy consumption

Compared to other industrial countries, energy consumption in Finland has traditionally been relatively high, measured on a per capita or a per unit of GDP basis. This reflects especially severe climatic conditions, high transportation costs, and the predominance of energy-intensive industries such as paper and pulp, chemical, and metal industries. In 1979, the share of industrial energy consumption in total final consumption was thus 41 per cent in Finland, compared to some 35 per cent for the OECD as a whole (Table 32). The consumption of the residential sector, mainly for purposes of space heating, was 37 per cent, by contrast with 24 per cent for all OECD countries. The composition of energy consumption is quite similar to that in Sweden (Table 32), though residential consumption takes up a larger share in Finland, while transportation is relatively more important for Sweden. From 1973 to 1979, the growth of energy consumption in relation to real output was 1.0 in Finland against 0.9 for total OECD. However, total energy consumption in 1980 increased by only 1 per cent, while Finland's real GDP growth was about 5 per cent. This declining trend continued in the first half of 1981, when energy consumption dropped by 1 per cent compared to the first half of 1980, despite a rise in GDP of 2 per cent. Part of this development is explained by the surge in energy prices from the end of 1979 which reinforced energy conservation efforts, particularly by households. The authorities expect that energy consumption will continue to grow more slowly in the early 1980s, possibly limiting the rate of growth of energy consumption to two thirds of that of real GDP.

2. Energy supply

As Finland has no indigenous production of oil, coal, or gas, it is heavily dependent on imported energy (Table 33). The energy import bill has been rising strongly. Comparing the two periods of sharp price increases, the energy bill increased by about Fmk 3 billion from 1973 to 1975, but by as much as Fmk 9 billion from 1978 to 1980. In 1980, energy imports amounted to Fmk 17 billion (29 per cent of total imports). Only 29 per cent of the energy consumed was covered by domestic energy supplies, which mainly consist of hydropower, wood and wood-based fuels, and peat. In recent years, a diversification of energy resources has taken place, with the share of oil ^{1/} in the total energy supply dropping from 56 per cent in 1973 to 45 per cent in 1980 (43 per cent in the first half of 1981), while the share of nuclear power and coal has increased.

In recent years the development of nuclear energy has been facilitated by less public opposition to this energy source than in many other countries. During the 1970s, two 420-megawatt nuclear power plants were ordered from the U.S.S.R. and built in Loviisa in southeast Finland, and two 660-megawatt plants were provided by Sweden and installed in Olkiluoto in southwest Finland. In 1980, all four of these plants were in operation and provided 7 per cent of the total energy supply and about 30 per cent of the delivery for the electricity grid. In the first half of 1981, the share of nuclear power jumped to 13 per cent in total energy supply. It is expected that nuclear power will account for 12 per cent of the total energy supply by 1985. The energy program agreed in 1979 stated that the authorities would consider building a 1,000-megawatt

^{1/} About two thirds of oil and oil products are imported from the U.S.S.R. (crude oil and refined petroleum products), with the remainder primarily provided by the OPEC countries.

coal-fired, peat-fired, or nuclear power plant to satisfy the electricity demand of the 1990s. A decision on whether to build such a plant and, if so, what type of plant to construct, will probably be taken in 1982.

The development of further indigenous energy sources is centered on the exploitation of the vast peat resources which cover around one third of Finland's surface, but are scattered in small deposits. Large-scale development of peat was not economical until the strong rise in oil prices. During the last couple of years, Finland has become one of the most advanced countries in the development of peat resources and is exporting its technology in this field. One of the disadvantages of using peat is that peat-fired plants are much more expensive to construct than oil-fired plants; in this respect peat is similar to coal. Also, peat is mostly available in thinly populated areas with only a few industries, making transportation expensive. Nonetheless, the running cost of a peat-fired plant is only about half that of an oil-fired plant. In 1980, 0.7 million tons of oil equivalent (Mtoe) were supplied by peat. The target is to reach 2.5-3.0 Mtoe by 1990, corresponding to 5-7 per cent of total energy consumption.

3. Energy pricing and policies

The Government controls domestic oil and electricity prices. Increases in import prices are passed on to consumers, although there have been some delays in the past, due to the decision procedure. Prices of various energy products have tended to be lower in Finland than in other European countries. Taxation on energy products is relatively low. Further, the cost of importing energy has been moderated by economies of scale due to a limited number of importers and some very large, long-term contracts. However, high transportation costs have had the opposite effect. Crude oil from the U.S.S.R. is priced in relation to OPEC prices. Oil products from the U.S.S.R. are priced at Rotterdam (spot) prices. Consumer prices of fuel and electricity changed remarkably little in relation to all consumer prices from 1973 to 1979 (Table 34). However, after the latest hike in energy prices, the prices of fuel and electricity increased sharply. In the first half of 1981, they exceeded the average 1979 level by more than 40 per cent, in contrast to a rise of just over 20 per cent for all consumer prices.

In March 1979, the Council of State approved a medium-term energy program, ^{1/} which included suggestions for energy conservation, increased exploitation of indigenous energy sources, and energy research. No major changes in energy policy took place in 1980 or in 1981. The most potentially rewarding areas for energy-saving are space heating by households and, to a lesser degree, energy consumption by industry. The budgets for 1980 and 1981 included appropriations for energy conservation measures which were below the levels proposed in the medium-term program. In particular, subsidies for energy conservation in buildings have been halved, because the energy price increase in itself motivated strong efforts to increase energy efficiency, hence obviating the need for subsidies. The total amount available for these measures is relatively limited. Peat production by the State has also increased significantly. The electricity tax was raised from Fmk 0.01 to Fmk 0.013 per kwh with effect from January 1, 1981.

^{1/} A detailed description of the program was included in the 1979 consultation report (SM/80/26), pp. 92-93, January 29, 1980.

Table 1. Finland: National Accounts Summary

	1980 ^{1/} In millions of Finnish markkaa (current prices)	1976	1977	1978	1979	1980 ^{1/}	1981 ^{2/}
		In constant 1975 prices; percentage change from preceding period					
Private consumption	101,892	0.9	-1.4	2.6	5.6	2.5	1.0
Public consumption	34,538	5.6	4.1	3.8	3.7	4.2	3.5
Gross fixed investment	45,789	-8.8	-5.4	-8.7	3.8	9.6	4.0
Private	(39,924)	(-9.4)	(-6.2)	(-10.1)	(4.1)	(10.8)	(4.5)
Public	(5,865)	(-4.2)	(0.7)	(0.7)	(1.5)	(2.7)	(3.0)
Final domestic demand	182,219	-1.2	-1.5	-0.2	4.8	4.5	2.2
Stockbuilding ^{3/}	5,418	-3.1	-2.5	-0.9	4.1	1.0	-2.5
Total domestic demand	187,636	-4.1	-4.0	-1.1	9.4	5.6	--
Exports of goods and services	63,797	14.8	9.4	8.1	9.2	9.4	2.0
Imports of goods and services	65,294	-3.3	-6.2	-3.1	16.1	11.9	-4.5
Foreign balance ^{4/}	-1,497	4.7	4.5	3.3	-1.2	-0.3	2.0
Gross domestic product	186,139	0.3	0.4	2.3	7.6	5.0	2.0
Memorandum items:							
Price deflators							
Exports of goods and services		4.4	14.3	7.5	12.0	10.8	10.5
Imports of goods and services		6.9	16.3	11.1	15.0	16.2	12.5
GDP at market prices		12.6	10.1	7.7	7.5	9.4	11.0

Sources: Central Statistical Office, Tilastotiedotus, "National Accounts;" Ministry of Finance, Economic Survey, 1981; and information provided by the Finnish authorities.

^{1/} Preliminary.

^{2/} Official estimates.

^{3/} Real change in stockbuilding, including the statistical discrepancy, in per cent of real GDP of the preceding year. If the statistical error were excluded, the figures for 1978-80 would read -0.5, 5.1, and 0.9, respectively.

^{4/} Real change in the foreign balance in per cent of real GDP of the preceding year.

Table 2. Finland: National Income and Personal Disposable Income

	1980 ^{1/}	1978	1979	1980 ^{1/}	1981 ^{2/}
	In millions of Finnish markkaa at current prices	Percentage change from preceding year			
Wages and salaries	84,746	5.9	14.7	16.1	13 1/2
Employers' contributions to social insurance	19,772	3.7	13.5	19.7	11
Net entrepreneurial income	34,367	18.0	20.4	8.5	10 1/2
Indirect taxes less subsidies	19,473	18.4	11.5	17.4	16
National income at market prices	158,358	9.5	15.4	14.9	12 1/2
National income at factor costs	138,884	8.4	16.0	14.6	12
Undistributed corporate profits	8,776	101.6	85.7	10.3	10
Net property and entrepreneurial income of general government	193	48.8	-17.4	-61.4	-51
Personal income ^{3/}	129,916	4.3	13.2	15.3	12 1/2
Direct taxes paid by persons ^{3/4/}	37,909	-2.5	7.7	15.3	16
Transfers received by persons ^{3/}	18,624	11.3	7.3	11.4	16
Personal disposable income ^{3/}	107,449	11.8	13.3	13.5	12
Consumption	101,892	10.5	13.8	13.7	13
Savings	5,557	38.4	5.4	9.0	-10
<u>Memorandum items:</u>					
Savings as a per cent of personal disposable income		5.8	5.4	5.2	4.2
Wages and salaries and employers' contributions as per cent of national income		65.5	65.0	66.0	66.2
Personal disposable income de- flated by consumer price index, percentage change		3.7	5.1	2.3	--

Sources: Central Statistical Office, Tilastotiedotus, "National Accounts;" and information provided by the Finnish authorities.

^{1/} Preliminary.

^{2/} Official estimates.

^{3/} Households and nonprofit institutions.

^{4/} Including social insurance contributions paid by, paid on behalf of, or imputed to households and nonprofit institutions; also including compulsory fees.

Table 3. Finland: Gross Fixed Investment

	1980 ^{1/} In millions of Finnish markkaa at current prices	1970-79 Compound annual average	1978	1979	1980 ^{1/}	1981 ^{2/}
			In constant 1975 prices; percentage change from preceding year			
Total gross fixed investment	45,789	2.0	-8.7	3.8	9.6	4
By industry						
Agriculture, forestry, and fishing	4,024	0.7	-1.9	5.2	9.1	-1
Manufacturing, mining and construction	9,664	0.8	-19.0	12.8	29.8	7
Electricity, gas and water	3,046	8.5	-36.3	27.3	-5.2	28
Transport and communications ^{3/}	6,591	-0.2	-10.3	-0.5	5.5	...
Commerce ^{4/}	2,389	1.3	0.7	11.1	6.8	3
Ownership of dwellings	12,637	3.2	-1.7	-3.5	4.3	1 1/2
Other services	2,995	3.0	12.0	0.3	12.2	...
Other ^{5/}	4,444	2.1	-0.2	-1.1	4.8	...
By type of asset						
Buildings	22,499	2.8	-2.9	-0.8	7.5	1 1/2
Other construction	5,907	-0.3	-4.6	-1.4	0.1	1
Machinery and equipment	17,383	2.0	-18.2	13.4	16.5	9
By sector						
Nongovernment	39,924	2.3	-10.1	4.1	10.8	4 1/2
Government	5,865	0.1	0.7	1.5	2.7	3

Sources: Central Statistical Office, Tilastotiedotus, "National Accounts;" Ministry of Finance, Economic Survey, 1981; and information provided by the Finnish authorities.

^{1/} Preliminary.

^{2/} Official estimates.

^{3/} Includes substantial public investment.

^{4/} Includes restaurants and hotels.

^{5/} Includes government (excepting investment in transportation and communications), and nonprofit organizations.

Table 4. Finland: Gross Domestic Product by Sector of Origin

	1980 ^{1/} In millions of Finnish markkaa at current prices	1970-79 Compound annual average	1978	1979	1980 ^{1/}	1981 ^{2/}
			In constant 1975 prices; percentage change from preceding year			
Agriculture, hunting, and fishing	7,406.3	0.3	-0.8	2.9	5.0	-1
Forestry	7,786.5	0.4	4.5	20.6	-1.3	-4
Mining and quarrying	840.8	3.1	3.9	7.5	5.0	-5
Manufacturing	47,885.7	4.0	4.1	11.0	8.1	2 1/2
Electricity, gas, and water	5,558.7	7.1	6.7	7.3	4.8	-2
Building construction	8,900.2	2.8	-2.2	1.0	8.0	1 1/2
Land and waterway construction	3,201.6	-0.7	-3.2	0.5	-0.7	1/2
Transport and communications	13,557.4	4.1	2.8	10.8	5.7	2
Commerce	19,168.8	4.0	1.9	7.3	3.2	1 1/2
Banking and insurance	11,545.2	5.1	2.0	4.1	5.5	2 1/2
Other services ^{3/}	16,797.5	4.2	3.1	3.7	3.4	2 1/2
Public sector activity	25,133.2	5.2	4.2	4.2	4.0	3 1/2
Other GDP	3,013.4	-0.3	1.5	1.8	2.4	2
GDP at factor cost	166,113.3	3.7	2.7	7.4	5.1	2
GDP at market prices	186,139.1	3.8	2.3	7.6	5.0	2

Sources: Central Statistical Office, Bulletin of Statistics; Ministry of Finance, Economic Survey, 1981; and information provided by the Finnish authorities.

^{1/} Preliminary.

^{2/} Official estimates.

^{3/} Including use of owner-occupied and rental housing.

Table 5. Finland: Labor Force and Employment

	1977	1978	1979	1980 ^{1/}	1981 ^{2/}	1981 ^{1/3/}	
						1st qtr.	2nd qtr.
(In thousands, period averages)							
Population of working age ^{4/}	3,561	3,578	3,593	3,606	3,625	3,621	3,625
Labor force	2,248	2,253	2,273	2,315	2,354	2,292	2,382
Unemployment	137	169	139	112	119	129	119
Employment	2,111	2,084	2,134	2,203	2,235	2,163	2,263
Agriculture and forestry	272	256	250	253	253	242	249
Manufacturing ^{5/}	578	562	581	605	614	605	628
Construction	154	151	150	149	154	145	155
Other	1,107	1,115	1,153	1,196	1,214	1,171	1,231
(In thousands)							
Net immigration	-11	-9	-7	-2	2	--	1
(In per cent)							
Participation rate	63.1	63.0	63.3	64.2	64.9	64.9	65.0
Unemployment rate	6.1	7.5	6.1	4.8	5.1	4.8	5.2

Sources: Central Statistical Office, Bulletin of Statistics; and information provided by the Finnish authorities.

^{1/} Preliminary.

^{2/} Official estimates.

^{3/} The quarterly unemployment rate and participation rates are seasonally adjusted. Other quarterly data are not adjusted.

^{4/} Aged 15 to 74 years.

^{5/} Includes mining and quarrying; and electricity, gas, and water.

Table 6. Finland: Growth of Output, Employment,
and Labor Productivity, by Sector

	1970-79 Compound annual average	1977	1978	1979	1980 ^{1/}	1981 ^{2/}
	Percentage change from preceding year					
Output ^{3/}						
Total	3.7	0.5	2.7	7.4	5.1	2
Agriculture, hunting, and fishing	0.3	-3.0	-0.8	2.9	5.0	-1
Forestry	0.4	7.6	4.5	20.6	-1.3	-4
Manufacturing ^{4/}	4.9	0.2	4.4	10.6	7.7	2 1/2
Construction	1.7	0.1	-2.5	0.8	5.7	1
Other GDP	4.3	0.4	2.9	5.7	4.1	2 1/2
Employment						
Total	0.2	-2.4	-1.3	2.4	3.2	1 1/2
Agriculture, hunting, and fishing	) -6.8	-9.0	-6.7	-3.8	--	--
Forestry	) -5.8	-4.1	4.3	8.2	-8	
Manufacturing ^{4/}	0.7	-1.5	-2.8	3.4	4.1	1 1/2
Construction	-2.3	-5.0	-2.0	0.7	-1.3	3 1/2
Other GDP	2.9	-0.9	0.8	3.2	3.7	1 1/2
Total hours worked						
Total	-0.6	-2.4	-1.2	0.8	0.7	1/2
Agriculture, hunting, and fishing	-4.7	-4.0	-3.7	-7.1	-7.2	-3
Forestry	-6.6	-2.7	-4.8	10.5	-0.3	-8
Manufacturing ^{4/}	0.6	-4.6	-2.9	4.2	3.5	1 1/2
Construction	-1.9	-2.7	-3.7	-0.1	2.0	1
Other GDP	1.2	-0.7	1.1	1.5	1.6	1 1/2
Average labor productivity						
Total	4.3	3.0	4.0	6.6	4.4	1 1/2
Agriculture, hunting, and fishing	5.3	1.1	3.1	10.8	3.2	2
Forestry	7.5	10.6	9.7	9.2	-1.0	4
Manufacturing ^{4/}	4.3	5.0	7.6	6.1	4.1	1
Construction	3.6	2.9	1.3	1.0	3.6	--
Other GDP	3.1	1.1	1.8	4.2	2.5	1

Sources: Central Statistical Office, Bulletin of Statistics; Tilastotiedotus, "National Accounts;" Ministry of Finance, Economic Survey, 1981; and information provided by the Finnish authorities.

^{1/} Preliminary.

^{2/} Official estimates.

^{3/} Value added at 1975 prices.

^{4/} Including mining and quarrying; and electricity, gas, and water.

Table 7. Finland: Wages, Costs, and Prices

(Percentage change from preceding year or corresponding period of preceding year)

	1970-79 Compound annual average	1978	1979	1980	1981 ^{1/}	1980		1981	
						1st half	2nd half	1st half	2nd half
Index of wages and salaries ^{2/}	13.1	6.7	11.5	11.9	12.5	10.2	13.3	12.9	
Negotiated wage rates	8.9	4.5	9.8	9.5	10				
Wage drift	4.2	2.1	1.6	2.1	2 1/2				
Real wages and salaries ^{3/}	2.6	-1.0	3.7	0.2	1 1/2	-0.1	0.4	-0.1	
Unit labor costs									
Whole economy	11.8	2.4	5.9	10.9	11	11.4	10.8	11.5	
Manufacturing ^{4/}	11.5	-0.4	4.5	10.6	10	10.4	10.8	...	
Consumer prices ^{5/}	10.2	7.8	7.5	11.6	12	10.3	12.8	13.0	
"Domestic supply prices" ^{6/}									
Domestic goods		3.7	8.8	16.0	13	14.9	17.0	15.4	
Imported goods		12.4	12.8	17.7	13	19.7	15.8	13.6	
GDP deflator		7.7	7.6	9.4	11	7.0	11.5	12.0	

Sources: Central Statistical Office, Bulletin of Statistics; Ministry of Finance, Economic Survey; and information provided by the Finnish authorities.

1/ Official estimates.

2/ Wages are on a per-hour basis. Only ordinary-time pay is included.

3/ Adjusted for the change in consumer prices.

4/ Includes mining and quarrying, and electricity, gas, and water.

5/ The weights for this series were revised with effect from February 1979.

6/ The weights for this series were revised with effect from June 1979. "Domestic supply" here refers to the comprehensive system of producer price indices, data from which were first published in July 1979 and replace the previous wholesale price index system.

Table 8. Finland: Central Government
Revenue and Expenditure

(Cash basis; including extra-budgetary funds)

	1978	1979	1980	1981
	Actual			Official estimates
(In millions of Finnish markkaa)				
Revenue <u>1/</u>	34,538	38,151	44,301	51,850
Income and property tax	9,262	9,471	12,213	15,750
Sales tax	9,550	10,649	12,262	14,000
Excise duties	6,772	8,204	9,233	10,535
Customs and import charges	581	629	784	840
Redemption of loans granted	563	750	751	870
Other revenue	7,811	8,448	9,057	9,855
Expenditure	36,996	42,818	48,436	55,380
Consumption	10,446	11,821	13,702	15,695
Transfers <u>2/</u>	18,872	22,416	25,238	29,400
Fixed investment	3,772	3,944	4,098	4,500
Lending	2,806	2,952	3,349	3,505
Other financial investment	510	517	540	550
Other expenditure	591	1,169	1,509	1,730
Surplus or deficit (-)	-2,458	-4,667	-4,135	-3,530
Memorandum items:	(Percentage change from previous year)			
Price deflators <u>3/</u>				
Consumption	5.7	9.4	11.8	12.0
Transfers	5.9	8.9	12.2	12.8
Fixed investment	5.8	6.2	13.0	11.3
Financial investment	5.5	10.2	14.0	11.2
Other expenditure	5.5	9.8	16.2	13.8
Total	5.8	8.7	12.4	12.3

Sources: Central Statistical Office, Bulletin of Statistics; and information provided by the Finnish authorities.

1/ Excluding transfers to and from the government countercyclical fund, which are treated as a financing item.

2/ Including net deficit or surplus (-) of state enterprises (approximately equal to Fmk 250-350 million in recent years).

3/ From indices prepared by the Ministry of Finance for Central Government expenditure on a cash flow basis.

Table 9. Finland: Central Government Revenue

(Cash basis; including extra-budgetary funds)

	1980 Percentage distribution	1978	1979	1980	1981 1/
		Annual percentage change			
Income and property tax	27.6	-11.6	2.3	29.0	29.0
Corporate sector	3.3	-1.9	13.1	17.5	...
Households	24.3	-12.5	1.0	30.1	...
Sales tax	27.7	15.3	11.5	15.1	14.2
Excise duties	20.8	17.7	21.1	12.5	14.1
Customs duties and import charges	1.8	-10.2	8.3	24.6	7.1
Other tax revenue	11.0	4.1	-0.4	3.7	12.6
Total tax revenue	88.9	4.0	9.0	17.0	18.0
Nontax revenue	11.1	20.4	23.2	9.8	9.0
Total government revenue 2/	100.0	5.5	10.5	16.1	17.0
<u>Memorandum items:</u>					
Percentage change, relative to GDP change, of					
Direct taxes		-1.1	0.2	1.9	2.2
Indirect taxes		1.2	0.8	0.8	1.0
Total tax revenue		0.4	0.6	1.1	1.4
General adjustment to income taxes, per cent		-13	-8	-7 1/2	-11

Sources: Central Statistical Office, Bulletin of Statistics; and information provided by the Finnish authorities.

1/ Official estimates.

2/ Excluding transfers to and from the government countercyclical fund.

Table 10. Finland: Central Government Expenditure

(Cash basis; including extra-budgetary funds)

	1980 Percentage distribution	1978	1979	1980	1981 ^{1/}
		Annual percentage change			
Consumption	28.3	11.0	13.2	15.9	14.5
Transfers ^{2/}	52.1	10.4	18.8	12.6	16.5
Of which:					
Local government	(21.0)	(15.5)	(13.9)	(12.9)	(17.7)
Agricultural price subsidies	(6.3)	(-5.8)	(16.1)	(4.6)	(22.9)
Households	(14.1)	(8.2)	(10.0)	(10.2)	(19.9)
Other transfers	(10.7)	(17.1)	(46.6)	(19.6)	(7.2)
Fixed investment	8.5	4.5	4.6	3.9	9.8
Lending	6.9	-6.2	5.2	13.4	4.7
Other financial investment	1.1	-25.8	1.4	4.4	1.9
Other expenditure	<u>3.1</u>	<u>7.5</u>	<u>97.8</u>	<u>29.1</u>	<u>14.6</u>
Total government expenditure ^{3/}	100.0	7.7	15.7	13.1	14.3

Sources: Central Statistical Office, Bulletin of Statistics; and information provided by the Finnish authorities.

^{1/} Official estimates.

^{2/} Including net deficit of state enterprises.

^{3/} Excluding transfers to and from the government countercyclical fund.

Table 11. Finland: Financing of the Central Government
Surplus/Deficit

(In millions of Finnish markkaa)

	1978	1979	1980	1981 Est.
Surplus/deficit (-) <u>1/</u>	-2,458	-4,468	-4,135	-3,500
Financed by:				
Foreign sector <u>2/</u>	<u>3,003</u>	<u>2,283</u>	<u>1,522</u>	<u>1,950</u>
State borrowing	3,287	2,559	1,791	2,500
Redemptions	-284	-276	-269	550
Bank of Finland <u>3/</u>	<u>-683</u>	<u>-403</u>	<u>-426</u>	<u>...</u>
Claims on Government	205	209	314	...
Government bonds	(33)	(52)	(143)	...
Coin <u>4/</u>	(-5)	(-6)	(4)	...
Other	(177)	(163)	(167)	...
Government deposits (increase -)	-888	-612	-740	...
Treasury checking account	(--)	(--)	(--)	...
Export levy and countercyclical tax accounts <u>2/</u>	(3)	(--)	(--)	...
Countercyclical fund <u>2/</u>	(-1)	(-2)	(-540)	...
Deposit certificates <u>2/</u>	(-890)	(-610)	(-200)	...
Deposit money banks <u>3/</u>	<u>-1,218</u>	<u>1,135</u>	<u>1,055</u>	<u>...</u>
Claims on Government	243	-45	764	...
Bonds in commercial banks	(155)	(-61)	(510)	...
Post Office Bank claims	(75)	(-3)	(212)	...
Bonds in other banks	(14)	(19)	(43)	...
Government deposits (increase -) <u>5/</u>	-1,462	1,180	291	...
Domestic nonbank borrowing <u>6/</u>	<u>1,356</u>	<u>1,453</u>	<u>1,984</u>	<u>...</u>
Total	2,458	4,468	4,135	3,500
Memorandum item:				
Gross long-term borrowing	5,282	4,743	5,002	5,000

Sources: Central Statistical Office, Bulletin of Statistics; IMF, International Financial Statistics; and information provided by the Finnish authorities.

1/ Excluding transfers to and from the government countercyclical fund, which are treated as a financing item.

2/ From Treasury accounts.

3/ From Bank of Finland accounts.

4/ Including "Finnish coin" held by the Bank of Finland and excluding "Treasury coin" issued to the public.

5/ Excluding lending funds that are included in government expenditure.

6/ Including errors, omissions, and float items.

Table 12. Finland: Central Government Ordinary Budget and Cash Outturn^{1/}
(In millions of Finnish markkaa)

	1980		1981		1982	
	Ordinary budget	Cash outturn	Ordinary budget	Cash outturn 2/	Ordinary budget 3/	Ordinary budget 3/
Revenue 4/						
Income and property tax	11,290	12,213	15,200	15,750	17,930	17,930
Sales tax	12,000	12,262	13,900	14,000	15,240	15,240
Excise duties	8,932	9,233	10,571	10,535	11,647	11,647
Taxes and charges levied on imports	1,105	1,471	1,360	1,490	1,570	1,570
Other tax revenue	3,810	4,295	4,748	4,715	5,290	5,290
Total tax revenue	37,137	39,384	45,779	46,490	51,677	51,677
Other revenue 1/	4,082	4,917	4,899	5,360	6,594	6,594
Total revenue	41,220	44,301	50,677	51,850	58,271	58,271
Expenditure						
Consumption	13,336	13,702	15,498	15,695	17,743	17,743
Transfers 5/	26,230	25,238	30,355	29,400	35,328	35,328
Fixed investment	3,536	4,098	3,824	4,500	4,200	4,200
Lending and other financial investment	2,901	3,889	2,986	4,055	3,187	3,187
Other expenditure	1,213	1,509	1,531	1,730	1,961	1,961
Total expenditure	47,216	48,436	54,194	55,380 6/	62,419	62,419
Surplus/deficit	-5,996	-4,135	-3,517	-3,530 6/	-4,148	-4,148

Sources: Central Statistical Office, Bulletin of Statistics; Ministry of Finance, Economic Survey; and information provided by the Finnish authorities.

1/ Supplementary budget and extrabudgetary transactions are included in the outturn figures but excluded from the ordinary budget figures.

2/ Official estimates.

3/ Proposal.

4/ Excluding transfers to and from the government countercyclical fund.

5/ Including net deficit of state enterprises.

6/ Including estimates for two supplementary budgets.

Table 13. Finland: Local Government Revenue and Expenditure 1/

(In millions of Finnish markkaa)

	1978	1979	1980	1981 ^{2/}
Revenue				
Property and entrepreneurial revenue	819	749	887	930
Direct taxes	12,494	14,095	15,600	18,200
Indirect taxes and fees	66	73	80	90
Transfers from public agencies	7,843	9,064	10,851	12,810
Other revenue <u>3/</u>	<u>1,524</u>	<u>1,781</u>	<u>2,023</u>	<u>2,340</u>
Total revenue	22,746	25,761	29,441	34,370
Current expenditure				
Consumption	16,724	19,017	22,015	25,650
Subsidies	254	250	263	270
Transfers to households	696	784	902	1,000
Transfers to public agencies	726	840	837	905
Other expenditure <u>4/</u>	<u>1,526</u>	<u>1,717</u>	<u>1,989</u>	<u>2,265</u>
Total current expenditure	19,926	22,608	26,006	30,090
Current operating surplus	2,820	3,152	3,435	4,280
Capital account transactions				
Gross capital formation	3,210	3,529	4,101	4,800
Consumption of fixed capital and capital transfers, net	1,226	1,344	1,569	1,810
Net lending	836	967	903	1,290

Sources: Ministry of Finance, Economic Survey; and information provided by the Finnish authorities.

1/ These data are on a national accounts basis.

2/ Official estimates.

3/ Imputed social insurance contributions and casualty insurance benefits.

4/ Casualty insurance premiums, pension expenditure, and interest.

Table 14. Finland: Government Income and Expenditure on National Accounts Basis, as per cent of GDP ^{1/}

	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980 ^{2/}	1981 ^{2/}
General government ^{3/}											
Revenue and income	36.5	36.3	36.9	36.7	37.8	42.3	41.6	39.5	38.0	37.9	39.0
Current expenditure	28.6	28.8	27.6	28.9	32.2	34.1	35.2	35.2	34.7	34.3	34.8
Saving	7.9	7.5	9.6	7.9	6.6	8.2	6.4	4.3	3.3	3.6	4.2
Consumption of fixed capital and capital transfers	0.7	0.8	0.7	0.7	0.5	0.8	0.9	0.9	0.8	0.8	0.8
Gross capital formation ^{4/}	4.0	4.4	4.2	3.9	4.4	4.1	4.1	3.8	3.6	3.7	3.7
Net lending	4.6	3.9	5.8	4.7	2.7	5.0	3.2	1.4	0.5	0.8	1.3
Central government											
Revenue and income	22.6	22.9	23.0	22.8	22.8	25.9	25.0	23.9	22.7	22.9	23.8
Current expenditure	17.2	17.4	16.2	17.1	19.5	20.6	21.2	21.4	21.6	21.5	21.9
Saving	5.4	5.5	6.8	5.6	3.3	5.3	3.7	2.5	1.2	1.4	1.9
Consumption of fixed capital and capital transfers	--	0.2	--	--	-0.5	--	0.1	--	-0.1	--	--
Gross capital formation ^{4/}	2.1	2.3	2.1	1.8	2.0	1.8	1.7	1.5	1.4	1.5	1.4
Net lending	3.4	3.4	4.7	3.8	0.8	3.5	2.1	1.0	-0.3	-0.2	0.4

Source: Information provided by the Finnish authorities.

^{1/} GDP data for all years are on the revised (1979) national accounts basis.

^{2/} Preliminary or official estimates.

^{3/} "General government" is comprised of the Central Government, municipal governments and intermunicipal authorities, and the national social insurance system. In these consolidated figures, transfers among governmental units are netted out.

^{4/} Excluding gross capital formation by general government enterprises. Including purchases of land and changes in inventories.

Table 15 Finland. Changes in Reserve Money and Selected Contributing Factors
(Period-average data; 1/ changes over preceding period; in millions of Finnish markkaa)

Components of Net Domestic Assets 3/																
	Reserve Money2/	Net Foreign Assets	Net Domestic Assets3/	Credit to financial institutions (gross)				Credit to private sector (net)			Credit to Government (net)		Other			
				Discounts4/	Call Money5/	Overdrafts6/	Cash reserve deposits	Other	Total	Investment	Other deposits	Total		Other	Certificates of deposit7/	Total
1975	378	-445	823	566	61	1	--	155	783	78	-40	38	28	601	629	-629
1976	247	-292	539	-207	12	38	--	64	-93	-182	-2	-184	391	800	1,191	-376
1977	209	-229	439	-271	112	-52	--	230	18	1,048	17	1,065	-158	-138	-296	-346
1978	525	2,047	-1,552	-1,002	-23	8	--	150	-884	112	8	120	-201	-426	-627	-131
1979	1,302	3,266	-1,963	-1,459	510	74	-587	762	-701	113	-50	63	478	-1,842	-1,364	39
1980	2,259	-1,279	3,538	-305	2,535	582	-2,080	2,411	3,144	486	-351	135	658	3	661	-401
1979 I	586	1,707	-1,121	-137	-304	7	--	47	-387	51	2	53	167	-722	-554	-231
II	255	1,349	-1,094	-539	--	12	-230	266	-491	64	-34	30	265	-916	-652	18
III	621	818	-197	-341	195	129	-504	532	10	111	-52	59	-124	-297	-421	155
IV	614	-3,002	3,616	--	2,296	-56	-763	983	2,460	92	-11	81	-43	1,005	962	113
1980 I	649	536	113	--	-221	486	-664	609	210	146	-30	116	728	-717	11	-225
II	637	-816	1,453	--	1,429	269	-355	336	1,679	106	-160	-54	-46	70	23	-197
III	354	551	-198	--	-519	-191	-357	505	-561	171	-257	-83	14	593	607	-160
IV	485	108	377	--	496	-147	-242	801	909	128	-119	9	-57	-20	-77	-464
1981 I	444	1,204	-760	--	-592	-60	-352	551	-452	120	-80	40	-370	683	313	-660
II	-392	671	-1,063	--	-1,466	-2	739	-599	-1,328	128	-220	-92	62	666	729	-372
III	-304	961	-1,265	--	-1,152	16	298	-234	-1,073	244	-356	-112	-55	267	212	-292

Source IMF, International Financial Statistics.

11/ Average of end-of-month data centered at mid-point

22/ Currency in circulation plus banks' reserve and other deposits

3/ Defined as reserve money minus net foreign assets.

4/ Discounted bills.

5/ Net call money advances of Bank of Finland.

66/ Check account overdrafts.

7/ Central Bank certificates of deposits held by the Government

7/ CENTRAL BANK CERTIFICATES OF DEPOSITS

Table 16. Finland: Monetary Policy Measures Affecting Bank Liquidity

(In billions of Finnish markkaa or per cent)

		Quota Debt <u>1/3/</u>	Check Account Over- drafts <u>1/</u>	Call money overdrafts ^{1/} At call money rate	At supplementary charge <u>4/</u>	Cash Reserve Ratio <u>2/</u>
1979	January	1.0	--	5.0	--	--
	February	1.0	--	5.0	--	--
	March	1.0	--	5.0	--	--
	April	0.5	--	4.0	--	--
	May	0.5	--	4.0	--	0.2
	June	0.5	--	4.0	--	0.4
	July	--	0.2	5.0	--	0.8
	August	--	0.2	5.0	--	1.2
	September	--	0.2	5.0	--	1.6
	October	--	0.2	5.0	--	2.0
	November	--	0.2	5.0	--	2.4
	December	--	0.2	5.0	--	2.8
1980	January	--	0.2	5.0	--	3.2
	February	--	1.0	5.0	3.0	3.2
	March	--	1.0	5.0	3.0	3.4
	April	--	1.0	5.0	3.0	3.6
	May	--	1.0	5.0	3.0	3.8
	June	--	0.9	4.5	2.7	3.8
	July	--	0.9	4.5	2.7	3.8
	August	--	0.7	2.8	2.1	4.2
	September	--	0.7	2.8	2.1	4.2
	October	--	0.7	3.5	2.1	4.2
	November	--	0.7	3.5	2.1	4.2
	December	--	0.6	3.0	1.8	4.6
1981	January	--	0.5	2.7	1.6	4.6
	February	--	0.6	3.0	1.8	4.6
	March	--	0.6	3.0	1.8	4.6
	April	--	0.6	3.0	1.8	4.0
	May	--	0.6	3.0	1.8	3.6
	June	--	0.6	3.0	1.8	3.0
	July	--	0.6	3.0	1.8	3.0
	August	--	0.6	3.0	1.8	3.0
	September	--	0.6	2.4	1.8	3.0
	October	--	0.6	2.4	1.8	3.0
	November	--	0.6	2.4	1.8	3.0
	December	--	0.6	2.4	1.8	3.0

Sources: Bank of Finland, Monthly Bulletin; and information provided by the Bank of Finland.

1/ In billions of Finnish markkaa.

2/ In per cent of financial institutions' deposit base, defined as their total demand and time deposits plus 50 per cent of residents' foreign currency deposits at end of preceding month.

3/ Mostly discounted bills. Further credit up to an amount of 50 per cent of basic quota was available at supplementary charge.

4/ Amount of credit available at first supplementary charge (commonly 4 per cent above call money rate). Further call money credit in addition to the two above tranches is available since February 1980 at higher penalty rates (8 per cent above call money rate between February 1, 1980 and May 31, 1980; and 10 per cent thereafter).

Table 17 Finland: Interest Rates
(In per cent per annum)

	Bank of Finland Rates				Selected Deposit Rates ^{2/}				
	Average cost of bank				Savings deposits	Time deposits			
	Discount rate ^{1/2/}	Call money rate ^{3/}	Borrowing from central bank ^{3/}	Bond yield ^{4/}		6 months	12 months	24 months	
1978 March	8.25	13.08	8.31	10.54	—	—	—	—	7.50
June	7.25	9.43	7.05	9.63	—	—	—	—	6.50
September	7.25	9.18	7.90	9.40	—	—	—	—	6.50
December	7.25	9.29	7.94	9.27	—	—	—	—	6.50
1979 March	7.25	8.29	7.53	9.30	—	—	—	—	6.50
June	7.25	8.35	7.52	9.34	—	—	—	—	6.50
September	7.25	8.68	8.03	9.36	—	—	—	—	6.50
December	8.50	13.53	12.76	9.58	—	—	—	—	6.50
1980 January	8.50	12.70	11.79	9.94	—	—	—	—	8.25
February	9.25	11.14	10.18	10.29	—	—	—	—	9.00
March	9.25	11.97	11.19	10.38	2.0	2.0	2.0	2.0	9.00
April	9.25	12.36	11.62	10.58	—	—	—	—	9.00
May	9.25	12.49	11.01	10.49	—	—	—	—	9.00
June	9.25	12.50	17.50	10.48	—	—	—	—	9.00
July	9.25	12.50	12.18	10.54	—	—	—	—	9.00
August	9.25	12.50	13.06	10.54	—	—	—	—	9.00
September	9.25	12.50	13.93	10.41	—	—	—	—	9.00
October	9.25	12.50	13.31	10.49	—	—	—	—	9.00
November	9.25	12.50	12.60	10.46	—	—	—	—	9.00
December	9.25	12.50	13.43	10.46	—	—	—	—	9.00
1981 January	9.25	12.50	13.61	10.92	—	—	—	—	9.00
February	9.25	12.50	12.82	10.95	—	—	—	—	9.00
March	9.25	11.72	12.89	11.01	—	—	—	—	9.00
April	9.25	10.57	10.32	11.06	—	—	—	—	9.00
May	9.25	11.00	11.20	10.92	—	—	—	—	9.00
June	9.25	11.00	10.96	10.95	—	—	—	—	9.00
July	9.25	11.00	10.73	11.01	—	—	—	—	9.00
August	9.25	11.45	10.58	11.01	—	—	—	—	9.00
September	9.25	11.50	11.05	10.95	—	—	—	—	9.00
October	9.25	11.50	11.30	..	—	—	—	—	9.00

Sources. Bank of Finland, Monthly Bulletin; OECD, Financial Statistics; Union Bank of Finland, Unitas, Economic Quarterly Review.

^{1/} This is the former discount rate. The term "base rate" was adopted effective July 1, 1979, when discounting was discontinued. Thereafter, the base rate applied to check account overdrafts.

^{2/} End of period ^{3/} Daily average ^{4/} Average interest rate on Central Government bonds at issue. ^{5/} Commercial banks.

Table 18. Inland: Growth of Main Monetary Aggregates

(Period-average data, 1/ seasonally adjusted)

	Stock, end- Dec. 1974	1975	'976	1977	1978	1979	1980	1980				1981		Stock, end- June 1981				
	In millions of Fmk							1st	2nd	3rd	4th	1st	2nd	In millions of Fmk				
								qtr.	qtr.	qtr.	qtr.	qtr.	qtr.					
Change in per cent from corresponding period of previous year																		
Reserve money 2/	2,471	17.5	9.8	7.5	17.4	37.0	46.7	31.5	21.4	36.6	58.0	51.3	56.9	44.7	37.5	30.4	13.1	7,562
Narrow money (M1)	7,267	32.5	14.4	7.8	11.3	16.5	11.0	14.2	15.7	16.9	19.0	18.8	11.6	7.5	6.8	6.3	8.8	15,763
Of which:																		
Currency outside banks	2,150	17.8	9.4	7.8	15.0	17.7	9.8	18.6	19.1	16.8	16.5	12.3	9.8	6.8	10.2	12.4	12.8	4,471
Demand deposits	5,116	39.3	16.4	7.8	9.9	16.1	11.5	12.6	14.4	17.0	19.9	21.5	12.3	7.8	5.5	4.0	7.3	11,289
Broad money (M3)	34,902	23.3	14.1	12.1	14.6	15.9	16.0	15.4	15.5	15.4	17.2	17.6	15.4	15.0	14.1	13.3	14.6	85,423
Of which:																		
Time and savings deposits	27,601	20.8	14.2	13.3	15.4	15.7	16.5	15.8	15.4	14.9	16.7	17.3	16.2	16.8	15.7	14.8	15.8	69,953
Bank deposits, total	32,717	23.4	14.5	12.4	14.6	15.7	15.7	15.3	15.2	15.2	17.1	17.9	15.6	15.4	14.2	13.2	14.6	
Deposits with consumer cooperatives	921	17.3	17.5	12.5	2.5	-13.4	-10.5	-6.3	-12.4	-16.6	-18.4	-17.0	-12.7	-8.0	-3.4	-0.8	-0.1	1,039
Credit to the private sector	39,930	25.0	13.7	12.8	10.7	13.5	19.4	9.8	12.8	14.3	16.9	19.8	18.5	21.1	19.7	14.9	16.5	100,006
Of which:																		
Bank of Finland	763	136.7	52.1	9.9	-6.0	3.6	33.7	-10.8	-3.6	12.1	19.1	26.8	31.2	35.5	39.9	39.6	39.3	2,791
Deposit money banks	39,167	23.7	12.9	12.8	11.1	13.7	19.1	10.3	13.2	14.3	16.9	19.6	18.2	20.8	19.2	14.3	16.0	97,215

Source IMF, International Financial Statistics

1/ Average of end-of-month data centered at mid-point

2/ Currency in circulation plus banks' reserve and other deposits plus working balances of the private sector at the Bank of Finland.

Table 19. Finland. Balance of Payments
(In millions of Finnish markkaa, not seasonally adjusted)

	1977	1978	1979	1980	1981 Forecast (Bank of Finland)	1980 1st half	1980 2nd half	1981 1/ 1st half
A. Current account balance	-580	2,606	-761	-5,186	-2,945	-2,280	-2,906	138
Balance on goods and services	-340	2,723	-442	-4,805	-2,345	-2,053	-2,752	349
Trade balance	-156	2,468	-1,128	-5,455	-2,434	-2,378	-3,077	588
Services balance	-184	255	686	650	89	325	325	-239
Transportation, net	1,747	2,024	3,010	3,029	3,800	1,427	1,602	2,060
Travel, net	-23	141	157	324	452	-21	345	2
Investment income, net	-2,434	-2,717	-2,840	-3,308	-4,450	-1,510	-1,798	-2,254
Other services, net	526	803	359	605	287	429	176	-47
Transfer payments, net	-198	-211	-430	-451	-600	-267	-184	-211
Other, net	-42	94	111	70	--	40	30	--
B. Long-term capital, net 2/	1,825	3,699	942	182	3,470	713	-531	487
Corporations and financial institutions, net 2/	1,027	829	-1,383	-1,318	1,550	-462	-856	-302
Direct investment, net	-105	-116	-381	-383	-450	-211	-172	-251
Loans, trade credits received and securities issued.								
Drawings 2/	4,154	5,731	3,708	3,347	6,300	1,776	1,571	2,214
Repayments 2/	-2,569	-3,999	-4,147	-3,818	-3,700	-1,861	-1,957	-1,909
Export credits, net	-241	-774	-541	-433	-600	-210	-223	-216
Others, net	-212	-13	-22	-31	--	44	-75	-140
Government, net	798	2,870	2,325	1,500	1,920	1,175	325	789
C. Short-term balance, net	-1,443	-3,053	536	5,510	1,845	3,519	1,991	2,319
Authorized banks	-279	-703	1,211	3,930	--	2,184	1,746	213
Other	-1,164	-2,350	-675 ^{6/}	1,580 ^{6/}	1,845 ^{6/}	1,335 ^{6/}	245	2,106 ^{6/}
D. Net errors and omissions	-800	899	-99	580	--	-1,879	2,459	-2,240
E. Overall balance (A - D)	-998	4,151	618	1,086	2,370	73	1,013	704
F. Monetary movements of the Bank of Finland, net 3/ 4/	-998	4,151	618	1,086	2,370	73	1,013	704
Monetary gold	12	7	7	--)		--	--	--
SDRs	-60	97	134	-33)		140	-173	124
Reserve position in Fund	--	246	-14	159)	2,300	--	159	--
Convertible currencies, net	182	2,118	121	715)		1,001	-286	167
Foreign bonds	62	287	1,097	339)		292	47	-793
Payments agreements, net	48	-38	-1,160	-94)		-1,360	1,266	1,206
Compensatory borrowing	-1,242	1,258	--	--		--	--	--
IMF account liabilities 5/	--	176	433	--	70	--	--	--

Sources: Bank of Finland, Monthly Bulletin and Statistical Report, and data provided by the Finnish authorities.

1/ Preliminary figures.

2/ Excluding oil facility drawing of Fmk 514 million in May 1977, drawings by the Bank of Finland on foreign credit facilities of Fmk 1,242 million in November and December 1977, repurchases under oil facility of Fmk 176 million in September and November 1978, redemption by the Bank of Finland of drawings on foreign credit facilities of Fmk 1,258 million in May and November 1978, and repurchases under oil facility of Fmk 433 million in February, May, and August 1979.

3/ A positive figure indicates an increase in net reserves.

4/ Excluding valuation adjustments.

5/ Oil facility.

6/ Including the allocation of SDRs, Fmk 139 million in 1979, Fmk 133 million in 1980, and Fmk 131 million in 1981.

Table 20. Finland: Balance of Payments
(In millions of SDRs, not seasonally adjusted)

	1977	1978	1979	1980	1981 Forecast (Bank of Finland)	1980 1st half	1980 2nd half	1981 1/ 1st half
A. Current account balance	-123	506	-151	-1,068	-580	-469	-599	27
Balance on goods and services	-72	528	-87	-990	-462	-422	-568	69
Trade balance	-33	479	-224	-1,124	-479	-488	-636	116
Services balance	-39	49	137	134	17	67	67	-47
Transportation, net	371	393	598	623	748	293	330	409
Travel, net	-5	27	31	67	89	-4	71	--
Investment income, net	-517	-526	-564	-681	-876	-310	-371	-447
Other services, net	112	156	72	125	56	88	37	-9
Transfer payments, net	-42	-41	-85	-93	-118	-55	-38	-42
Other, net	-9	18	21	15	--	8	7	--
B. Long-term capital, net 2/	387	717	187	37	683	147	-110	97
Corporations and financial institutions, net 2/	216	160	-275	-270	305	-95	-175	-60
Direct investment, net	-22	-23	-76	-79	-89	-43	-36	-50
Loans, trade credits received and securities issued:								
Drawings 2/	883	1,112	738	686	1,240	366	320	441
Repayments 2/	-546	-776	-825	-783	-728	-384	-399	-380
Export credits, net	-51	-150	-107	-88	-118	-43	-45	-43
Other, net	-48	-3	-5	-6	--	9	-15	-28
Government, net	171	557	462	307	378	242	65	157
C. Short-term balance, net	-306	-592	105	1,135	363	725	410	459
Authorized banks	-59	-136	241	810	--	450	360	62
Other	-247	-456	-136 ^{6/}	325 ^{6/}	363 ^{6/}	275 ^{6/}	50	417 ^{6/}
D. Net errors and omissions	-171	174	-19	119	--	-388	507	-444
E. Overall balance (A - D)	-212	805	122	223	466	15	208	139
F. Monetary movements of the Bank of Finland, net 3/ 4/	-212	805	122	223	466	15	208	139
Monetary gold	3	1	1	--)	--	--	--	--
SDRs	-13	19	27	-7)	--	29	-36	24
Reserve position in the Fund	--	48	-3	32)	--	--	32	--
Convertible currencies, net	39	411	24	147)	453	206	-59	33
Foreign bonds	13	56	217	70)	--	60	10	-157
Payments agreements, net	10	-7	-230	-19)	--	-280	261	239
Compensatory borrowing	-264	244	--	--)	--	--	--	--
IMF account liabilities 5/	--	34	86	--	13	--	--	--

Sources: Table 19. Converted from Finnish Markkaa using period-average exchange rates from IMF, International Financial Statistics. For 1981, the average rate for the first 9 months of 1981 is used for the year as a whole.

1/ Preliminary figures.

2/ See footnote 2 in Table 19.

3/ A positive figure indicates an increase in net reserves.

4/ Excluding valuation adjustments.

5/ Oil facility.

6/ See footnote 6 in Table 19.

Table 21. Finland: Foreign Trade

	1977	1978	1979	1980 ^{1/}			1981 ^{1/}		
				1980 ^{1/}			1981 ^{1/}		
				1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.
				(Seasonally adjusted) 2/					
				(In millions of Finnish markkaa)					
Trade balance, total	223	2,868	-792	-5,455	-809	-1,567	-1,805	-847	704
Market economies	511	2,933	2,218	-2,114	490	-628	-967	-929	388
State trading economies	-286	53	-3,011	-3,341	-1,552	-879	-838	82	316
Exports (f.o.b.), total	30,931	35,206	43,430	52,793	13,013	12,686	13,803	13,699	14,663
Market economies	23,967	27,844	36,207	41,997	11,818	10,226	10,817	10,331	10,745
State trading economies	6,964	7,355	7,223	10,798	2,195	2,460	2,986	3,368	3,918
Imports (c.i.f.), total	30,708	32,338	44,222	58,250	14,075	14,193	15,608	14,546	13,959
Market economies	23,456	24,911	33,989	44,111	10,328	10,854	11,784	11,260	10,357
State trading economies	7,250	7,408	10,234	14,139	3,747	3,339	3,824	3,286	3,602
									4,615
									16,118
									11,503
									4,444
(Percentage change from preceding year)									
In value terms 3/									
Exports (f.o.b.), total	26.2	13.8	23.4	21.6	31.6	14.6	25.5	16.7	13.3
Market economies	28.6	16.2	30.0	16.0	35.8	12.0	16.4	4.0	-0.6
State trading economies	18.5	5.6	-1.8	49.5	12.0	26.9	79.7	78.3	92.0
Imports (c.i.f.), total	7.5	5.3	36.7	31.7	48.9	38.7	35.7	11.8	-0.6
Market economies	5.2	6.2	36.4	29.8	40.9	38.6	32.1	13.4	-1.0
State trading economies	15.8	2.2	38.1	38.2	83.3	36.6	45.7	6.4	0.5
In volume terms									
Exports, f.o.b.	9.5	7.4	9.9	9.5	18.8	2.5	15.7	3.2	1.7
Imports, c.i.f.	-7.5	-4.7	19.6	12.1	17.3	15.1	19.2	-0.7	-10.5
Unit values									
Exports	14.9	6.2	12.4	11.5	10.7	11.8	8.5	13.1	11.4
Imports	16.5	10.9	15.6	16.8	27.1	20.1	13.8	12.5	11.1
Terms of trade	-1.4	-4.2	-2.8	-4.5	-12.8	-6.9	-4.6	0.5	+0.3
Ratio of import growth to GDP growth (volume)	-20.7	-2.1	2.6	2.4	3.2	5.7	2.3	-0.2	-12.4
									-0.4

Sources: Bank of Finland, Monthly Bulletin; and Central Statistical Office, Bulletin of Statistics.

1/ Preliminary.

2/ Seasonally adjusted by method of three-month moving average. The quarterly figures do not add to the annual figures.

3/ The figures in value terms are not comparable with the product of the volume and unit value figures, since they differ somewhat in coverage.

Table 22. Finland: Direction of Trade

(At current prices)

	Exports (f.o.b.)					Imports (f.o.b.)								
	1980 1/		1977	1978	1979	1980	1981 1/	1980 1/		1977	1978	1979	1980	1981 1/
	In millions		In per		Percentage change from		Jan.-Oct.	In millions		In per		Percentage change from		Jan.-Oct.
	of Fmk	cent	cent	cent	previous year	previous year		of Fmk	cent	cent	cent	previous year	previous year	
OECD	36,422	69.0	28.6	14.1	32.8	13.0	3.0	36,144	62.1	3.8	7.8	32.4	27.2	10.4
Of which:														
Denmark	1,840	3.5	18.7	22.0	19.0	7.9	2.2	1,394	2.4	2.3	8.2	27.5	25.2	-4.6
France	2,389	4.5	22.6	30.1	42.4	25.3	-3.7	1,778	3.0	7.9	29.1	36.5	23.1	7.1
Germany	5,606	10.6	35.0	13.7	34.7	17.3	-2.2	7,348	12.6	2.5	3.5	31.0	28.8	-1.7
Netherlands	2,259	4.3	44.3	16.8	41.4	24.6	-11.0	1,474	2.5	18.7	9.1	30.3	23.8	8.3
Norway	2,206	4.2	92.9	5.4	32.0	-5.6	33.7	1,224	2.1	29.4	-21.0	24.9	9.3	28.0
Sweden	8,718	16.5	17.3	5.8	35.6	25.0	-8.1	7,031	12.1	-5.8	13.6	31.3	15.0	-5.2
United Kingdom	5,940	11.3	7.1	21.0	28.1	4.6	9.8	5,005	8.6	22.0	11.1	29.0	31.1	-1.4
United States	1,667	3.1	93.5	1.2	33.4	-9.9	37.5	3,373	5.8	-9.9	13.2	36.6	52.0	38.9
CMEA	10,523	19.9	17.4	4.9	-2.4	49.1	66.9	14,399	24.7	16.6	2.3	36.9	39.8	10.1
Of which:														
U.S.S.R.	9,303	17.6	20.1	4.3	-4.6	55.4	79.0	12,233	21.0	15.4	0.2	41.1	41.7	12.4
Other countries	5,848	11.1	32.4	34.4	11.9	41.5	20.7	7,696	13.2	25.8	-3.3	58.6	39.9	-33.4
Of which:														
Oil exporting countries	2,333	4.4	60.5	19.9	10.3	49.8	15.8	4,628	7.9	9.4	-22.2	134.4	62.6	-25.8
Total	52,793	100.0	26.3	13.8	23.4	21.6	16.4	58,239	100.0	7.6	5.3	36.2	31.7	3.1
Of which:														
EFTA	12,423	23.5	34.2	6.0	33.6	18.2	-0.4	10,250	17.6	-0.4	6.3	30.0	15.5	0.6
EC	20,389	38.6	21.6	20.0	32.6	14.4	3.0	19,478	33.4	8.7	9.0	32.0	28.0	0.9

Sources. Bank of Finland, Monthly Bulletin, Board of Customs, Foreign Trade; and OECD, Trade by Commodities, Series B.

1/ Preliminary figures.

Table 23. Finland: Exports (f.o.b.)
by Main Commodity Groups

	1980- In millions of Finnish markkaa	In per cent	Percentage change over previous year										
			In value terms					In volume terms					
			1977	1978	1979	1980- 1/	1981- 1/ 1st half	1977	1978	1979	1980- 1/	1981- 1/ 1st half	
Agriculture, forestry and fishing	1,221	2.3	35.4	-14.1	43.6	1.6	53.4	12.7	-21.3	19.0	16.7	40.4	
Wood industry	7,742	14.7	33.3	20.4	30.9	27.5	-3.3	10.3	21.6	17.2	7.6	-13.8	
Paper and graphic industry	15,751	29.8	11.9	18.2	24.9	21.2	13.0	6.1	14.0	12.3	6.5	0.9	
Metal and machine industry	11,547	21.9	33.3	4.5	7.8	11.6	40.9	3.4	-5.0	4.4	3.4	22.9	
Textile, clothing, and leather industry	4,132	7.8	18.2	14.9	23.5	27.3	30.6	4.1	4.0	14.3	16.7	21.2	
Other	12,402	23.5	38.7	21.8	34.8	29.5	12.2	...	...	...	...	...
Total	52,795	100.0	26.2	13.8	23.4	21.6	18.8	10.3	7.0	9.4	9.3	6.8	

Source: Central Statistical Office, Bulletin of Statistics.

1/ Preliminary figures.

Table 24. Finland: Export Market Shares by Selected Commodity Groups

(Percentage change (U.S. dollar terms) from previous year)

	1977	1978	1979	1980 ^{1/}
Total trade				
Export market growth <u>2/</u>	13.9	16.9	28.2	18.8
Export value growth	20.9	11.8	30.4	26.7
Relative export performance <u>3/</u>	7.0	-5.1	2.2	7.9
Manufacturing goods (SITC 5-8)				
Export market growth <u>2/</u>	15.2	22.9	23.8	16.0
Export value growth	19.9	11.8	26.6	22.6
Relative export performance <u>3/</u>	4.7	-11.1	2.8	6.6
Wood products (SITC 24)				
Export market growth <u>2/</u>	13.4	19.2	40.6	...
Export value growth	35.7	16.6	41.8	36.0
Relative export performance <u>3/</u>	22.3	-2.6	1.2	...
Pulp products (SITC 25)				
Export market growth <u>2/</u>	-4.8	1.5	35.5	...
Export value growth	-3.7	13.3	59.9	30.7
Relative export performance <u>3/</u>	1.1	11.8	24.4	...
Paper, paperboard, etc. (SITC 64)				
Export market growth <u>2/</u>	9.7	20.7	26.0	...
Export value growth	9.4	16.8	25.7	24.9
Relative export performance <u>3/</u>	-0.3	-3.9	-0.3	...
<u>Memorandum items:</u>				
Share of total Finnish exports:				
Manufacturing goods	77.4	77.4	75.2	72.8
Wood products	8.6	8.9	9.7	10.4
Pulp products	5.1	5.2	6.4	6.4
Paper, paperboard, etc.	22.8	23.8	23.0	22.6

Sources: OECD, Trade by Commodities, Series B, and Statistics of Foreign Trade, Series A; and Board of Customs, Foreign Trade.

^{1/} Preliminary figures and partly staff estimates.

^{2/} Annual change in import values of the OECD countries (unweighted).

^{3/} Growth of Finnish export value minus export market growth.

Table 25. Finland: Imports (c.i.f.) by Main Commodity Groups

	1980 In millions of Finnish markkaa	In per cent	1977	1978	1979	1980	1981 ^{1/}		1977	1978	1979	1980	1981 ^{1/}	
							1st half						1st half	
							Percentage change over previous year						In volume terms	
In value terms														
Percentage change over previous year														
Raw materials and producer goods	38,662	66.3	7.3	6.8	41.3	33.7	1.1	-8.0	0.1	22.1	10.4	-10.2		
Of which:														
Crude oil	11,580	19.9	16.2	-6.9	72.0	56.0	14.1	3.4	-9.2	21.6	-0.1	-14.4		
Fuels and lubricants														
Of which:														
Petroleum products	2,601	4.5	21.5	2.4	92.4	10.5	-3.8	7.8	-6.6	-2.2	-3.4	-11.1		
Investment goods	7,989	13.7	-2.8	-0.6	19.1	39.7	24.1	-17.6	-18.6	14.5	31.4	15.6		
Consumer goods	7,440	12.8	12.2	4.9	27.0	21.3	5.8	-1.8	-9.2	22.9	15.7	-1.4		
Other	111	0.2	7.8	-37.4	75.0	22.0	-51.7	...	...	...	...	...
Total	58,250	100.0	7.5	5.3	36.7	31.7	5.8	-7.5	-4.7	19.6	12.1	-5.7		

Sources: Central Statistical Office, Bulletin of Statistics; and Board of Customs, Foreign Trade.

^{1/} Preliminary figures.

Table 26. Finland: Indicators of Competitiveness

(Percentage change over previous year)

	1977	1978	1979	1980	1981 1st half
Exchange rates					
Dollars per markka					
Average period	-4.1	-2.1	5.7	4.4	-10.0
End of period	-6.2	2.3	5.8	-3.4	-18.4
Currency index of the Bank of Finland					
Average period	-5.8	-9.5	-0.1	3.3	1.0
End of period <u>1/</u>	-10.2	-5.9	2.7	2.0	--
Nominal effective rate (MERM)					
Average period	-5.5	-9.5	3.1	4.5	-3.5
End of period <u>2/</u>	-9.8	-5.9	7.3	0.3	-4.8
Profitability indicators <u>3/</u>					
Manufacturing sector	-0.4	18.1	7.8	-5.4	...
Forest industry	54.7	77.6	26.2	0.2	...
Metal industry	-20.6	14.6	6.3	-15.5	...
Ratio of export prices <u>4/</u> to domestic unit labor costs					
Staff estimate	6.9	2.9	6.8	4.8	-0.9
Bank of Finland	6.5	6.3	7.2	0.8	...
Relative unit labor costs <u>4/</u>					
Staff estimate <u>5/</u>	-6.0	-12.6	-0.6	-0.1	3.7
Bank of Finland <u>6/</u>	-5.2	-14.6	-1.8	-1.1	...

Sources: IMF, International Financial Statistics; data provided by the Finnish authorities; and staff calculations.

1/ December data for annual figures and June data for 1981.

2/ Fourth quarter data for annual figures and second quarter data for 1981.

3/ The capital income share of value added.

4/ Manufacturing goods.

5/ Finnish data compared to data for 16 industrial countries, weighted by bilateral merchandise trade in 1980 and corrected for exchange rate changes.

6/ Finnish data compared to five industrial countries, weighted by trade shares and corrected for exchange rate changes.

Table 27 Finland: Nonmonetary Long-Term Capital

(In millions of Finnish markkaa)

	1977	1978	1979	1980 ^{1/}	1981 ^{1/}	1977	1978	1979	1980 ^{1/}	1981 ^{1/}	1977	1978	1979	1980 ^{1/}	1981 ^{1/}	Jan-Sep	Jan-Sep	Net flow
	Inflow						Outflow						Net flow					
Long-term loans 2/	5,212	9,007	6,320	5,183	5,284	2,745	4,309	4,410	4,140	2,951	2,467	4,698	1,820	1,043	2,333			
Corporations and financial institutions 2/	4,154	5,731	3,708	3,347	3,559	2,569	3,997	4,147	3,818	2,572	1,585	1,734	-439	-471	987			
Of which:																		
Corporations	(3,430)	(4,693)	(2,972)	(2,469)	(2,836)	(2,222)	(3,522)	(3,558)	(3,066)	(1,790)	(1,208)	(1,168)	(-586)	(597)	(1,046)			
Financial institutions 2/	(724)	(1,037)	(736)	(878)	(723)	(374)	(475)	(589)	(752)	(782)	(377)	(566)	(147)	(126)	(-59)			
Import credits	1,716	634	451	304	341	901	1,099	1,084	850	543	815	-465	-633	-546	-202			
Individual financial loans	1,936	3,503	2,655	2,414	2,540	1,451	2,093	1,994	1,817	1,519	485	1,410	661	597	1,021			
World Bank loans	9	10	--	--	--	50	47	43	35	10	-41	-42	-43	-35	-10			
Bond loans	504	848	377	281	447	165	355	672	515	324	339	493	-295	-234	123			
Foreign government loans	--	--	--	--	--	7	2	2	2	2	-2	-2	-2	-2	-2			
Other loans	-10	735	225	348	231	--	401	352	599	174	-11	334	-127	-251	57			
Local authorities	156	--	64	33	23	21	22	31	77	53	135	-22	33	-44	-30			
Bond loans	--	--	--	--	--	14	12	12	12	16	-14	-12	-12	-12	-16			
Other loans	156	--	64	33	23	7	9	19	65	37	149	-9	45	-32	-14			
Central Government	902	3,276	2,458	1,803	1,702	155	290	232	245	326	747	2,986	2,226	1,558	1,376			
Foreign government loans	--	--	--	--	--	10	10	10	2	--	-10	-10	-10	-2	--			
World Bank loans	--	--	--	--	--	26	30	52	31	27	-26	-30	-52	-31	-27			
Bond loans	491	2,634	1,359	1,210	1,026	112	238	118	106	142	379	2,396	1,241	1,104	884			
Other loans	411	642	1,099	593	676	7	12	52	106	157	404	630	1,047	487	519			
Direct investment	188	141	106	104	63	293	257	487	487	509	-105	-116	-381	-383	-446			
Export credits	542	607	805	891	780	783	1,381	1,346	1,324	1,150	-241	-774	-541	-433	-370			
Miscellaneous capital	44	58	271	100	--	340	167	227	145	--	-296	-109	44	-45	-167			
Corporations and financial institutions	30	10	81	8	--	242	23	104	40	--	-212	-13	-23	-32	--			
Central Government	14	48	190	92	--	98	144	123	105	--	-84	-96	67	-13	--			
Total long-term capital 2/	5,986	9,813	7,412	6,278	--	4,161	6,114	6,470	6,096	--	1,825	3,699	942	182	1,350			

Sources: Bank of Finland, Monthly Bulletin and Statistical Report, Union Bank of Finland, Unitas, and data provided by the Finnish authorities.

^{1/} Preliminary.^{2/} See footnote 2 in Table 19

Table 28. Finland: Foreign Debt ^{1/}
(In millions of Finnish markkaa, end of period)

	1977	1978	1979	1980 ^{2/}	1981 ^{2/} June
Long-term					
Liabilities	29,123	34,037	33,703	34,655	37,845
Assets	2,966	3,776	4,126	4,630	5,332
Net long-term debt (In per cent of GDP)	26,157 (20.6)	30,261 (21.6)	29,577 (18.3)	30,025 (16.1)	32,513 (15.4)
Short-term ^{3/}					
Liabilities	15,999	15,166	19,489	31,178	34,554
Assets	15,070	19,974	24,467	31,987	33,277
Net short-term debt (In per cent of GDP)	929 (0.7)	-4,808 (-3.4)	-4,978 (-3.1)	-809 (-0.4)	1,277 (0.6)
Total foreign liabilities (In per cent of GDP)	45,122 (35.5)	49,203 (35.2)	53,192 (32.8)	65,833 (35.4)	72,399 (34.4)
Total foreign assets (In per cent of GDP)	18,036 (14.2)	23,750 (17.0)	28,593 (17.7)	36,617 (19.7)	38,609 (18.3)
Total net foreign debt (In per cent of GDP)	27,086 (21.3)	25,453 (18.2)	24,599 (15.2)	29,216 (15.7)	33,790 (16.0)
Memorandum items:					
Service payments on gross long-term debt	4,847	8,246	8,028	7,432	4,345
Service payments on net short-term debt and long-term debt ^{4/}	4,516	6,623	6,457	6,716	3,919
Amortization ^{4/}	2,082	3,769	3,472	3,274	1,629
Interest, etc.	2,434	2,854	2,985	3,442	2,290

Sources: Bank of Finland, Monthly Bulletin and Statistical Report; Union Bank of Finland, Unitas; and data provided by the Finnish authorities.

^{1/} Including the positions of the Bank of Finland and the commercial banks and excluding the equity proportion of direct investments and subscriptions to international financial institutions.

^{2/} Preliminary.

^{3/} With original maturities of less than one year.

^{4/} Excluding net repayment of short-term debt.

Table 29. Finland: Gross Long-Term Foreign Debt 1/

(In millions of Finnish markkaa, end of period)

	1977	1978	1979	1980	1981	
					March	June
Financial loans	22,695	27,716	28,194	29,730	30,523	32,814
Individual financial loans	11,922	12,385	12,608	13,602	13,949	15,130
Of which:						
Granted by foreign governments	(88)	(71)	(55)	(53)	(56)	(60)
Bonds and debentures	10,773	15,331	17,586	16,128	16,574	17,684
Bond loans	(6,189)	(7,755)	(12,054)	(10,901)	(10,918)	(12,061)
Private placements	(3,955)	(7,887)	(4,943)	(4,440)	(4,746)	(4,765)
EBRD	(387)	(345)	(258)	(189)	(191)	(74)
Debentures	(242)	(344)	(31)	(329)	(342)	(361)
Deposit certificate loans	—	—	—	(269)	(383)	(422)
Import credits	5,775	5,612	4,898	4,377	4,455	4,487
Ships and aircraft	2,582	2,447	1,968	1,701	1,772	1,805
Other commodity credits	3,193	3,165	2,930	2,676	2,683	2,682
Leasing credits	108	122	116	102	101	102
Direct investments	1,717	1,885	1,979	2,075	2,138	2,180
Equity capital	1,172	1,298	1,484	1,629	1,674	1,718
Loans to subsidiaries	545	587	495	446	464	462
Subscriptions to international financial institutions	61	109	184	238	341	304
Total	30,356	35,444	34,371	36,522	37,558	39,867

Sources: Bank of Finland, Statistical Report; Union Bank of Finland, Unitas; and data provided by the Finnish authorities.

1/ Including the positions of the Bank of Finland and commercial banks, on original maturities of at least one year.

Table 30. Finland: Gross Official Reserves

(End of period)

	1977	1978	1979	1980	1981		
					March	June	Sept.
(In millions of U.S. dollars)							
Gold ^{1/}	38.7	43.3	45.6	44.2	42.6	39.9	39.7
SDRs	50.8	80.5	116.1	103.7	131.1	121.0	158.5
Reserve position in the Fund	--	60.1	58.8	98.8	95.1	89.1	89.2
Foreign exchange	<u>480.3</u>	<u>1,082.4</u>	<u>1,365.1</u>	<u>1,667.7</u>	<u>1,552.4</u>	<u>1,390.0</u>	<u>1,264.4</u>
Total	569.8	1,266.3	1,585.6	1,914.4	1,821.2	1,640.0	1,551.8
(In millions of SDRs)							
Gold ^{1/}	31.9	33.3	34.7	34.7	34.7	34.7	34.7
SDRs	41.8	61.8	88.1	81.3	106.7	105.2	138.5
Reserve position in the Fund	--	46.1	44.6	77.5	77.4	77.4	77.9
Foreign exchange	<u>395.4</u>	<u>830.8</u>	<u>1,036.3</u>	<u>1,307.6</u>	<u>1,263.6</u>	<u>1,208.1</u>	<u>1,104.7</u>
Total	469.1	972.0	1,203.7	1,501.1	1,482.4	1,425.4	1,355.8
Memorandum item:							
Total reserves as per cent of imports (c.i.f.) during the previous 12 months	7.5	15.4	13.3	12.6	12.7	12.2	11.5

Source: IMF, International Financial Statistics.

^{1/} Gold valued at equivalent of SDR 35 per fine troy ounce.