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Trade Patterns and Economic Evolution

by T. R. G. Bingham, Helsinki *

Finland is the last one of the non-applicant EFTA countries to conclude a free trade agreement with the EC. The author takes a favourable view of its prospects particularly since it has come into force just as a cyclical down-turn was getting under way.

At the close of 1973 Finland completed the prolonged process of redefining its relations with the enlarged European Community by signing and ratifying a free trade agreement governing the exchange of industrial products. This accord is of particular importance for Finland since about a half of its trade is with the enlarged Community and because without it its major competitors in the rump EFTA — Sweden, Norway and Austria — would have had a considerable competitive edge.

A Comparison with the FIN-EFTA Treaty

Both the short period that has elapsed since the agreement came into force (January 1, 1974) and the considerable uncertainties engendered by the oil crisis make it impossible to predict with any confidence the full impact of the agreement on the Finnish economy. But it is both possible and rewarding to sketch the general effects and to delineate the cyclical impact of the change in the commercial environment.

The climate in which the present agreement has been worked out is remarkably similar to that in which the FIN-EFTA Treaty was negotiated in 1961. Then, as now:

- Finland followed a policy of resilient adaptation in order to safeguard its position in one of its major market areas;
- the agreement was of a purely commercial nature and designed to underscore Finland's neutrality, the keystone of its foreign policy;
- the agreement covered trade in manufactures and left the country free to follow its own agricultural and social policies;
- Finland simultaneously took steps to improve its trading relations in the East as well as in the West.

These similarities suggest that we can seek clues to the impact of the present agreement in the

* Bank of Finland. The views expressed do not necessarily reflect those of the Bank of Finland.

course of events following the signature of the FIN-EFTA Treaty. There were in fact two major consequences: a shift in the commodity composition of exports and a change in the importance of various countries as markets for Finnish goods.

Development of Export Structure

Prior to the EFTA period, the great bulk (about 70 p.c.) of Finnish exports came from its wood and paper industries. The overall percentage figures conceal the importance of trade in these products with other market economies because an unusually large share of Finnish exports of metal and machinery manufactures went to the East bloc. Greater access to the markets of the UK, Sweden and the other EFTA countries opened the way for export diversification. Exports of the forest based industries continued to expand and the degree of processing was upgraded considerably. But it was in the industries, which were not so strongly resource oriented and which had up to that point provided only a moderate quantity of exports, that growth was most rapid. Exports of such labour intensive industries as the manufacture of textiles and footwear were at the top of the export growth league, but the performance of some capital intensive branches such as the manufacture of basic metals and chemicals was also very respectable. On the whole the capital intensity of Finnish exports tended to fall over the EFTA period as exports of the highly capital intensive paper industry declined in relative importance. This sort of export diversification was quite welcome because it provided employment for the country's reserves of labour in foreign exchange earning activities. Moreover, dependence on a narrow product base was reduced.

This then is the general picture. More detailed information is given in Table 1, which shows the commodity composition of exports at the beginning and end of the EFTA period and for purposes of comparison, in 1951. The more rapid rise in the degree of processing during the EFTA

Table 1
Shares of Various Product Groups
In Finnish Exports *

Product Group	1951		1961		1971	
	Main group	Sub group	Main group	Sub group	Main group	Sub group
Primary Products	11.9		13.4		6.6	
Agriculture		1.7		4.6		5.5
Forestry		10.2		8.8		0.9
Industrial Products	88.1		86.6		93.4	
Wood industry		30.1		24.9		16.7
Paper Industry		52.0		45.6		37.6
Metal industry		3.8		11.4		23.5
Other industry		2.2		4.7		15.6

* Totals are not necessarily commensurate because some products, e.g., those of mining and quarrying, are omitted.

Source: Statistical Yearbook of Finland, 1962 and 1972.

period is clearly reflected in the eight percentage point decline in the share of forestry exports, compared with a drop of only 1.4 p.c. in the preceding ten year period. The greater pace of export diversification during the EFTA period can also be seen. Between 1951 and 1961 the share of metal and other industry products in total exports increased by about 10 p.c., but in the following ten year period, the increase in the share was more than twice as great, i. e., 23 p.c.

The conclusion of the EFTA agreement also had an influence on the regional distribution of Finnish exports, with EFTA countries gaining at the expense of EEC countries (cf. Table 2).

Table 2
Distribution of Finnish Exports by Trading Areas

Area	Year		
	1951	1961	1971
EFTA ¹	41.4	33.4	46.9
EEC (Original six)	23.3	30.8	22.4
East bloc ²	12.1	18.1	14.2
Other	23.2	17.7	16.5

¹ UK, Sweden, Denmark, Norway, Austria, Switzerland, Portugal.

² USSR, Poland, East Germany, Hungary, Czechoslovakia, Bulgaria, Rourmania.

Source: Official Statistics of Finland I A, 1951; Statistical Yearbook of Finland, 1962 and 1972.

In the years following World War II the six countries which would establish the EEC steadily grew in importance as markets for Finnish exports, and by 1961 they, like the EFTA countries, took over 30 p.c. However, after the EFTA agreement came into force, their position gradually deteriorated so that by 1971 only slightly more than 20 p.c. of Finnish exports went to the EEC, while somewhat less than half went to EFTA countries. The shift in the regional distribution of Finnish exports

following the country's adhesion to a free trade area indicates clearly that dismantling trade barriers has a definite allocative effect on trade flows.

Effects on Trade and Economic Development

If we extrapolate from these general trends and keep in mind the provisions of the free trade agreement with the European Community and changes in the economic environment, we should obtain a fairly accurate picture of the main effects of the agreement on the pattern of trade and the course of economic evolution. The forest based industries will in all likelihood continue to expand at a more moderate pace than the other export oriented industries. The agreement with the EC provides for a general transition of 3½ years, but for forest based products, this period is about three times as long. Moreover exports of these products in excess of a certain limit to Finland's former EFTA partners which are now members of the European Community will face a temporary rise in tariffs.

Forest based exports will also be held in check by a shortage of raw materials. For some years the wood and paper industry has been able to process more than the annual growth of Finland's forests, and raw wood has been imported. Since the costs of transporting rough timber, reclaiming land and cultivating forests preclude sharp growth in the supply of primary inputs, expansion will have to take the form of raising further the degree of processing. Unfortunately paper manufacturing is highly energy intensive — indeed over ten times more so than the manufacture of metal products — and it is likely that the higher price of oil will put this sector at a disadvantage relative to the newer export industries. Despite these difficulties, the prospects for growth are not totally bleak since forecasts indicate that the supply of paper will fall short of demand for almost the entire length of the transition period.

In recompense for the protection, which the Community has given its paper industries, Finland has obtained a longer transition period for some of its newer industries. At present Finnish duties on imports of machinery are relatively low and some of this industry's products such as wood processing machinery, cranes and boring equipment are quite capable of withstanding foreign competition. Other sectors of this industry are not yet well established, and they will benefit from tariff protection for a longer time. Moreover Finland's footwear, leather, plastics, textile and clothing industries will also benefit from a slower transition period.

The free trade agreement will give Finland's competitive basic metal and chemical industries access to a much wider market, and it seems safe to expect that exports of these industries will grow

faster than those of most other sectors for metal and chemical industry exports have expanded very rapidly even though they have received little tariff protection and had to scale rather high tariff barriers.

Favourable for Labour-intensive Industries

On the whole, the free trade agreement treats Finland's labour intensive industries more favourably, and should thus help them increase their share in total exports. This will further help the diversification of both the economy and trade. As in the past, this development is to be welcomed. Relative to most of its major market countries, Finland has an abundance of labour, and the bulk of accepted trade theory would suggest that it should specialize in the production of labour-intensive products. But it must be recognized that Finland is no longer a country with inexhaustible reserves of labour. It has ceased being a country of emigration, and in the most recent upswing severe shortages were experienced in some occupations and some regions, despite the persistence of structural unemployment in the northern and eastern parts of the country. A country with 18 p.c. of its labour force employed in agriculture and forestry would appear to have a certain amount of labour which could be released for work in other sectors. However, closer examination reveals that the average age of the farm population in Finland is quite high. Older farmers do not adjust easily or willingly to other jobs, and cannot be viewed as an important source of labour. The share of the primary labour force will fall over time, but primarily because the number of people retiring will exceed the number of new entrants.

Importance of Energy Supply

No doubt the free trade agreement will affect the importance of the various trade groupings as markets for Finnish exports. Were other things equal, it would seem reasonable to expect the original six EEC countries to increase their shares at the expense of both present and former EFTA members. However, we must again take note of the consequences of the oil crisis. Finland imports the bulk of its oil from the Soviet Union at a price which is linked with the Rotterdam index. The country's oil bill is expected to triple, and to pay it Finland will have to increase the quantity of its exports to the Soviet Union with the result that the share of the East bloc will in all likelihood rise. We can thus expect a trend towards the trading patterns of the early 1960s.

The energy crisis is of such great moment that any assessment of the prospects for growth and economic evolution must make some mention of it. Finland's position is not quite as precarious

as that of some of the other small nations of Europe. Some of its energy requirements are met domestically with hydroelectric power generated on its numerous rapids or through the burning of wood. Finland has vast reserves of peat which could, at least in principle, be converted into petrol or used to run local heating plants, and its neutrality should make the country less subject to oil embargoes. However, the demand for energy is particularly great in this northern country. Not only are its most important industries energy intensive, but the longer winters means that the need for oil for heating is great.

Moreover almost all domestic sources of energy — except peat — have been exploited, so that when energy policy plans were being formulated before the energy crisis occurred it was decided to increase the import of energy and to construct conventional power stations in the short run and nuclear power stations in the longer run. The most serious threat, however, comes from the potential fall in demand in Finland's major foreign markets: the UK, the Federal Republic of Germany and Sweden. There is very little hope that a small, open economy can do to cushion the effects of a major decline in export demand. The timing of the present free trade agreement may, however, help in a small way.

Favourable Turning of Free Trade Agreement

The other non-applicant EFTA countries concluded their agreements with the Community at a time when world demand was high. Finland, because of the need to examine the foreign policy implications of the accord and to navigate the document through particularly choppy Parliamentary waters, waited until the close of last year. A number of firms postponed investment decisions until the fate of the free trade agreement became clear, so that the agreement tended to bolster foreign demand and investment just as a cyclical downturn of unknown proportions was getting under way. Moreover, the bias in the agreement in favour of labour intensive industries should mean that it will provide particular help in buoying up employment.

It would thus appear that the free trade agreement will help Finland advance towards economic maturity by placing the newer, more expansive and less energy intensive industries at a still greater advantage. It should also lead to a rise in the shares of the original six as markets for Finnish exports. Although it was not consciously planned, the agreement was signed at a time that was quite propitious in light of cyclical conditions, so that on balance the agreement seems favourable to the Finnish economy in terms of both structural and cyclical policy.