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SPEECH GIVEN BY DR. MAUNO KOIVISTO, PRESIDENT OF THE REPUBLIC OF FINLAND, AT THE COLLEGE OF EUROPE, OCTOBER 28, 1992

Mr Rector,

Ladies and gentlemen:

I consider it a great honour to have this opportunity to speak today at the College of Europe. Could there possibly be a better forum for discussing the economic and political situation which prompted Finland to apply for membership of the European Communities and thus an opportunity to play a part in building up a European union of nations.

Despite our geographical location far in the north, we Finns have been intimately involved in the course of European history. A succession of major upheavals on the continent has brought changes to Finland in one way or another, ever since Christendom divided into the Roman Catholic and Byzantine Orthodox churches at the beginning of the millennium. The boundary between these two rival churches was to run right up through the area populated by the Finns, and was soon to have a political impact throughout the continent which is still felt even today.

Our location in a border region involved us in the subsequent conflicts, but also in a lively interchange of both economic and cultural influence. Our geographical position has also helped us to preserve and strengthen our national identity. And ultimately, the ups and downs of big-power politics provided the opportunity for Finland to gain independence. After 600 years as an integral part of Sweden and 100 years as an autonomous Grand Duchy of the Russian Empire, Finland declared its independence 75 years ago.

The first decades of Finnish independence were beset by political and economic difficulties, coming to a head when we found ourselves alone under attack from the Soviet Union in 1939 and engaged in an armed conflict - the Winter War - which lasted over three months. After yet another war with the Soviet Union the Finns gradually managed to rebuild their country and international standing.

The human losses in these wars were great; a large part of our territory was lost, one tenth of the population had to be resettled, and huge

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reparations had to be paid to the Soviet Union.

But Finland remained independent, and was never occupied. Our democratic institutions never stopped operating, either during or after the war.

Ladies and gentlemen :

In the 19th century Finland began to industrialize and to engage extensively in foreign trade. With a view to our current situation, it should be borne in mind that even in the past, too, indebtedness to lenders abroad has from time to time been a weak point in the Finnish economy. In the 1920s, soon after we gained our independence, economic growth was based significantly on foreign capital, and the net foreign debt in 1931 was equal to half our GDP.

In the '30s Finland won fame as a country that paid its debts. This was true in two respects. Firstly, Finland had obtained loans from the United States government in the early 1920's, and scrupulously repaid them. The victors in the First World War had loans on quite a different scale, which they proved unable to repay. To underline how poorly these major debtors handled their affairs, the US government and press never failed to make a big issue of Finland's conscientious repayment.

Secondly, Finland also paid its debts in other ways, and on a much greater scale: a foreign trade surplus was achieved, allowing Finland's net foreign debt to be virtually repaid by the outbreak of the Second World War.

In the three decades following the war, we were able to carry out a radical structural change and transform Finland from an agricultural to an industrial country. Economic growth relied on foreign trade under conditions in which the availability of foreign capital was very limited.

Finland joined the World Bank and the International Monetary Fund in 1948. Long-term loans were obtained from the World Bank for investment in infrastructures and the forest industry, and support for the balance of payments was received from time to time from the Monetary Fund.

Finland was not the only country to suffer from inflation and an overheated economy as a result of the collapse of the international monetary system and

the oil crisis at the beginning of the 1970s. Finland's foreign debt increased, and both the debt and inflation were successfully restrained only after stringent policy measures. In 1978, GDP was only a little larger than that in 1974.

Compared with many other countries, the Government debt remained rather small throughout the 1970s and 1980s. However, borrowing from abroad by the economy as a whole has constantly been one of our main problems.

An international economic downturn was expected in the mid-1980s, and many countries undertook measures to support economic activity. There was thinking along these lines in Finland, too, although fortunately hardly any stimulative measures had been taken before we realized that a slump was not forthcoming.

At the same time, our terms of trade improved dramatically; prices for Finnish exports rose substantially and those for imported energy fell.

Foreign capital movements were deregulated, a well-founded move for many reasons. It was generally believed that, with the other means at its disposal, the Government would be able to preserve equilibrium on financial markets, that the banks would display a proper sense of responsibility in intermediating foreign credit, and that people borrowing money would be able to accurately assess their capacity for meeting their commitments. Time was to prove otherwise.

Overheating occurred, and GDP rose by more than 15% in 1987-89.

Under these circumstances, the Government succeeded in keeping public finances in balance with relative ease. There was a financial surplus and loans were repaid. Obviously, we should have been showing a much bigger surplus than was the case, but it is very common for the urgent needs of the hour to gain precedence over the abstract threats of the future.

There were demands for the Government to increase housing construction at a time when the building sector was already overheated. Efforts were made to carry out an income tax reform, and to declare that taxes would fall. The media criticized the Government for making promises it could not keep. Unfortunately the Government did keep its promises and income taxes were

cut when taxes in general should have been raised substantially. Overall taxation rose marginally at the height of the boom.

The Bank of Finland tried to cool the economy. Raising domestic interest rates made foreign money even more attractive, and the Bank of Finland had to attempt to remove excess funds from the market and reinvest them abroad, as a foreign exchange reserve. Revaluation of the markka in spring 1989 was an attempt to alleviate this problem.

Efforts to keep the markka stable by curbing the rise in wage costs were also made. Here, we were to some extent successful, but now that we see the problems confronting the Finnish economy, we realize that wages in Finland became too high.

Finland's trade with the Soviet Union generally exceeded the share of Finnish trade accounted for by other Western countries. In 1989, Finnish exports to the Soviet Union were at the established level, that is, some 15% of total exports. The breakup of the Soviet Union led in two years to a decline to one-third of this figure. We lost 10% of our total exports.

Overheating of the securities and real estate markets, the collapse of the Soviet trade, and sagging demand on western markets in particular for the products of our forest industry eventually drove Finland into deep recession and depression. In 1991-1992 GDP dropped by 8%, and unemployment rose from less than 4% to 13%.

Under these circumstances, the primary task is to make our economy competitive. It is obvious that adjustments of this kind would not be smooth in any country, and disturbances inevitably occur, for example in the foreign exchange markets.

When, in summer last year, Finland unilaterally linked its currency to the EC currency basket, the ECU, without altering the external value of the markka consequently, domestic costs had to be adjusted.

In autumn last year we had an opportunity to conclude a broad incomes policy settlement that would help reduce costs. However, the unions were not yet ready for such a move, and their internal climate did not favour compliance. There were also those in industry who favoured devaluation. So

in November 1991 the growing outflow of foreign exchange first forced the Bank of Finland to allow the Finnish markka to float, and then the Government to devalue.

As pressures continued last spring, the Bank of Finland requested and received promises from central banks in the EC of substantial support for defence of the external value of the markka. However, interest rates remained high, and the outflow of foreign exchange grew stronger. In effect, the Bank of Finland's foreign exchange reserves were depleted. At this point, at the beginning of September, the Finnish markka was floated, this time for a longer period.

The Finnish markka has declined some 10% in value since it was floated. Interest rates remained high to start with, but in the last few days have declined steadily. Interest rates decrease as confidence in the value of the currency is restored. Further reductions in the value of the markka would not be good, either in terms of Finland's external economic relations or domestic factors. There is a danger that the labour market would be divided into overheated and 'overcooled' sectors.

The external value of the Finnish mark has declined some 20% over the past year, and inflation is at an annual rate of 2.6%.

The net foreign debt is approaching 40% of GDP. We must stop this trend before it reaches the all-time high it hit in 1931. The current account must be balanced as soon as possible. The open sector of the market that competes internationally must be expanded. This means that our credibility on international financial markets must be maintained, and the external value of the markka must be stabilized. We must also reduce our foreign debt, so that capital would be released for investment in the developing countries and in those European countries facing the necessity of economic restructuring.

Ladies and gentlemen:

Throughout the postwar period, Finland has been working towards closer international cooperation. This has been and continues to be the precondition for our economic progress.

We are a member of EFTA and in the early '70s signed Free-Trade

Agreements with the European Community.

We have been working actively to set up the European Economic Area between the Community and EFTA countries. We hope that the EEA agreement signed in May will be ratified soon so that the Area will come into effect at the beginning of next year. We in Finland have done everything we can to prepare for the new situation.

On March 18, Finland applied for membership of the European Community. The decision was taken following open and extensive debate in Parliament, in the political parties and throughout the nation at large. The application enjoyed broad support.

As a result of studies made, we concluded that the application for EC membership would be in our national interests. We applied for membership after carefully weighing up all the political and economic advantages and disadvantages that would accrue to Finland from it.

The EEA agreement is important as such and as a step towards membership. Membership of a European Union in accordance with the Maastricht Treaty would be in many respects something quite different. The main difference is that the EEA agreement does not give us full rights to sit at the table at which decisions intimately affecting us are made.

Though international cooperation has always been important for Finland, we are very much attached to our national independence, our culture and our self-reliance. These have been the resources that sustained us when the dangers were greatest and outside help tended to take the form of sympathy, rather than concrete aid.

Against this background, the decision to apply for membership of a Community aiming at ever closer union among the peoples of Europe is of signal importance.

Meeting today's political, economic and environmental challenges calls increasingly for cooperation at a higher than national level. Commitment to national values must therefore not prevent us from sharing our sovereignty with other nations which have the same basic values.

Finland is a large and sparsely populated country, but without close economic ties with other countries we would be unable to support even our present population.

For us, it is important to ensure that all parts of Finland remain populated. This can, no doubt, be reconciled with the Community's regional and agricultural goals. As in the earlier enlargements of the Community, adequate ways and means should be found to take our special circumstances into account.

The European Community is playing a growing role in determining the course of development on our continent. We would like to play a part in this process.

We have studied the obligations of EC membership with care. In applying for membership, we accept the *acquis communautaire*, the Maastricht Treaty and the *finalité politique* of the European Union. We are ready to accept the obligations conferred by membership and to help to meet them as agreed. At the same time, it is clear that, as a member of the Community, Finland must defend its own interests and viewpoints, as all the other Member States do.

Security remains a matter of crucial importance for a country like Finland: it underpins our very existence as an independent nation and state.

Europe is no longer divided. Nevertheless, unrest, conflict and violence are regrettably prevalent in certain parts of our continent.

We want to keep the areas immediately around us as politically and militarily stable as possible. We believe that these goals and the responsibilities of a member of the European Union can be reconciled.

Ladies and gentlemen:

The Finnish economy can survive and prosper only amid equal competitive conditions. Our present economic difficulties in no way change this fact.

In the long term, the EEA is not an adequate arrangement in this respect. The difficulties that our economy is suffering from show that we need more

stability. Close cooperation with other countries is needed if we are to achieve this, because our economies are now so interdependent.

It would seem that small and open economies like Finland need to move towards the Economic and Monetary Union foreseen by the Maastricht Treaty even more than stronger economies do. Of course, the past few weeks have shown that achieving a higher degree of stability is also in the interest of larger countries.

We in Finland hope that the membership negotiations will begin soon. I believe that we can bring them rapidly to a successful conclusion.