

ENGLISH SUMMARIES

MATTI LOUEKOSKI: *The State Budget Proposal for 1991.*

The strong economic growth in Finland during the last couple of years was based on buoyant international economic developments, improving terms of trade and particularly on the overheating in domestic demand, which was fuelled by the liberalization in the financial markets. Finnish exports have increased markedly slower than OECD's imports as strong domestic demand crowded out exports and price competitiveness weakened. In addition, our main export markets have grown less than the OECD average. As a result, our external balance has deteriorated rapidly; current account deficit and foreign indebtedness have become the most pressing problems in our economic policy.

The reversing of this trend is a lengthy process, exports should exceed imports during many years to come. This can be attained only by keeping domestic demand slow and by sufficient growth in export capacity.

Main emphasis in economic policy should be placed on improving the conditions of economic activity, particularly those in the open sector, and on promoting saving. In line with these policy considerations, the state budget for 1991 aims at improving the exposed sector's competitiveness. These

ALEXANDRE LAMFALUSSY: *International Financial Integration, External Balance and Financial Stability*

The author asks the question whether we can conclude that everything has been done to ensure the stability of the financial systems. Even though the answer would be »no», the author stresses that there is no remedy to be found in seeking to turn the clock back. We have to accept that internationalization and deregulation are here to stay. The Western industrial world's confidence in the benefits of the free market system has now been growing again for a decade or more. Any move to re-regulate financial market activity would be likely to receive very short shrift politically, unless the costs of not doing so were clearly enormous, and this cannot be demonstrated from the past ex-

perience. measures explain to a great extent the seemingly large growth in expenditure. The basic fiscal policy stance, on the other hand, is relatively tight.

The tax reform is carried on; income tax rates are reduced for both wage earners and firms, and changes are made in the present turnover taxation towards a full-fledged VAT-system. These measures bring the Finnish tax system closer to international practice. As for taxation, the Finnish business sector has no major disadvantage in relation to its foreign counterparts.

A marked increase in the savings ratio of the economy is a prerequisite for an improvement in the current account. Household savings are encouraged by introducing a comparatively low final withholding tax on interest income and by further increasing the part of interest expenditures not deductible in taxation.

Efficient ways ought to be found for restricting the increase in the local government sectorspending. The tightening of the local authorities' financial situation in 1991 will lead to cautious spending plans, but also to pressures on tax increases. The local governments are encouraged to more active user-charge policies. The state aid reform due in 1992 is expected to result in a more cost conscious behaviour in local governments.

perience.

But some important issues do remain unresolved: One is the behaviour of financial asset prices. Medium-term contradictions between asset prices and real fundamentals can result in resource misallocation. A second unresolved issue concerns the over-capacity in the banking and other financial institutions. It threatens to grow further as technology makes it increasingly easy for lenders and prime borrowers to avoid the use of intermediaries. Over-capacity contributes to the increasingly competitive environment and pressure on profit margins and many also see it as an important reason for the so-called short-term »churning» in the financial markets. The third longer-term issue which remains to be solved concerns the reaction of the supervisory authorities in the face of financial globalisation. Supervision needs to be globally co-ordinated, too.

JAMES W. KOLARI. *Anatomy of a Financial Disaster: The U.S. Thrift Crisis.*

Losses on savings and loan associations, or so-called thrifts, in the U.S. are estimated to reach approximately \$ 200 billion. The underlying cause of this financial disaster is a combination of mismatched asset and liability maturities among thrifts and high and volatile interest rates in the late 1970s and early 1980s. As interest rates on deposits exceeded the rates earned on portfolios of long-term fixed mortgages, many thrifts became insolvent, while others experienced subnormal capital levels. In an effort to prevent regulatory closure, a significant proportion of thrifts began investing in as-

sets with higher risks and relatively high potential returns to offset previous losses. Subsequently, a second wave of losses either pushed insolvent thrifts deeper into the red or caused increased insolvencies. The mounting losses surpassed federal insurance guarantees and spurred the passage of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989. This act provides funding to merge out or liquidate insolvent thrifts. It also restructures the regulation of the savings and loan industry. Unfortunately, FIRREA does not address the deposit insurance incentive for thrift (and bank) managers to take increased lending risks at the potential expense of the public.

SEPPO KOSTIAINEN — HANNA-LEENA MÄNNISTÖ: *How Fiscal and Income Policies Could Contribute to the Stability of External Equilibrium.*

The present study examines the role of stabilization policy in improving external equilibrium. We use the BOF4 quarterly model of the Finnish economy to evaluate how fiscal and incomes policy improve the economy's external stability and the implications of this for the real growth of the economy over the medium term. The effects of income and fiscal policies are compared to a case where the economy adjusts through changes in market interest rates. We also examine how the coordination of fiscal and income policies can achieve external stability with lower real adjustment costs than with fiscal or monetary policy alone. In addition, we consider how financial market deregulation has altered the relative efficiency of fiscal and income policies.

The need for coordinated stabilization policy for controlling the external balance is evident. According to our calculations, the benefits of coordinated economic policy are significant. If the adjustment takes place mainly through interest rates, it leads to a fall in productive investment and hence weakens the real competitiveness and longer-term growth of the economy. However, it does not seem to be possible to limit the growth of external debt without reducing domestic demand in the long run,

and thereby causing losses to real growth and employment. Even though the deregulation of financial markets has increased the effects of fiscal policy on external stability, it is not possible to control the growth of external debt merely by halting the real growth of public expenditure in the medium term. What is also required is a fall in the propensity to spend of the private sector and an increase in saving in the form of financial assets.

Lowering the growth of wages, without compensating for it in income taxation, is more favourable for external equilibrium in the circumstances of deregulated financial markets than in the case of regulated markets. In contrast, moderate wage agreements accompanied by tax reductions are, under these new conditions, even more expansive and problematic for external stability than earlier.

By combining reductions in fiscal expenditure with an incomes policy that aims at improving price competitiveness, the economy could reach both higher real growth and better external and internal stability than with interest rate policy alone. This result is insensitive to the assumption of whether the financial markets are regulated or not. In policy coordination we should utilize the fact that the financial deregulation has changed the trade-off between growth and external stability, when reducing the external debt. Thus financial market deregulation has not reduced the need for economic policy coordination.

KARI ALHO: *European Economic Area and Finland.*

Analysis of European integration shows that the EFTA countries benefit more from the EEA than the EC. This stems, first, from the fact that trade with the area has a higher share in the economies of the EFTA countries than in the EC and, secondly, that the small EFTA countries are likely to gain more from increased competition and utilization of scale economies.

The EC will carry out its internal market pro-

gram irrespective of the outcome of the EEA negotiations. Compared to this situation the EC cannot expect substantial new benefits from the EEA as the EFTA countries make up a relatively small additional market to the EC firms. Standard analysis of cooperative game theory therefore produces the result that in a reciprocal EEA the EFTA countries have to give up a part of their integration gains to the EC in order to get the EEA established. However, in this solution EFTA is better off than in a situation where the present integration process would not have been realized.

ARI LAHTI: *Macroeconomic Effects of European Integration on the Finnish Economy: A Simulation Study.*

The aim of this study is to discuss and to quantify the macroeconomic effects of further European integration on the countries outside the European Community. We use Finnish economy as an example in our quantitative analysis. However, for the most part of the study the analysis is in general level and thus can be applied to many other countries as well, especially to other EFTA countries.

During the course of the study we assume that the integration process as described in the White Paper of 1985 is successful, and that Finland will not become a member of the Community. Instead, Finland will create close relations with the internal market by participating into the process of creating the European Economic Space (EES), together with other member countries of EFTA.

By using the results of economic theory and existing studies on the effects of integration, we make

a simulation study with an econometric macro-model to quantify the consequences of this alternative. This study is organized in the following way. Section 2 outlines the methodology used for this study. Section 3 contains a short description of the econometric macromodel used in the course of the study. In section 4 we discuss the design of the simulations for our purpose, and in section 5 we present the outcome of these simulations. Evaluation of the simulation results and concluding remarks are made in the final section.

The simulation results presented in section 5 are the first quantitative estimates of macroeconomic consequences for the Finnish economy resulting from further European integration. According to the results, by participating into the integration process according to the way indicated by the government, there are clearly positive results from the integration to Finnish economy. The size of these effects indicate that the need for participating the economic integration process in Europe is obvious.

ILKKA KAJASTE: *What Will Happen to Finnish Manufacturing in the Integrating Europe.*

The article considers the sectoral impact of 1992 on Finnish manufacturing. The approach is based on a corresponding study in the EC (Buigues, Ilzkovitz, Lebrun 1990). In the first part of the article those industry sectors which are likely to be most affected by the abolition of trade barriers, were identified.

In the second part of the article the competitive-

ness of these sensitive sectors were examined. The indicators of competitiveness in the original EC study reflect different aspects of sectoral comparative advantage. However, one can criticize the relevance of these indicators when the bulk of trade between industrialized countries in Europe is intra-industry trade which is not driven by comparative advantage. Therefore, some auxiliary indicators (potential economies scale, relative unit labour costs, demand growth) were examined. The analysis indicates that in those of the sensitive sectors

which seem to be strong a relatively favourable development is likely to continue, because these sectors are expected to be growth industries also in future. However, in some of these sectors (electro-technical industry, chemical industry) a major readjustment might be necessary in order to exploit the potential economies of scale. Problem areas are those sectors of the food and construction material industries, which will be affected by the removal

of trade barriers and which will therefore become subject to effective international competition.

In the final part of the article alternative integration scenarios are examined. Because of differences in the sectoral incidence of trade barriers also effects of various integration alternatives (status quo, free trade area, customs union, EC membership) differ considerable.

VISA HEINONEN: *The Appearance of Marginalist Economics in Finland.*

This article examines the appearance of marginalist economics and first comments on it in Finland. The paradigm shift from classical political economy to marginalist or neoclassical economics inside the economic theory in the 1870's and the 1880's didn't receive very much attention in Finland before the 1920's. Only few scholars made comments on it in journal articles and lectures. In Sweden marginalist economics received attention already at an early stage. Theorists like *Knut Wicksell* (1851—1926) and *Gustav Cassel* (1866—1945) were influenced by marginalism and developed independent versions of the theory. The international discourse on Jevonsian, Walrasian and Mengerian versions of marginalism in economic theory was not reflected very strongly in Finland in the late 19th century. So, the article reviews the first Finnish reflections and comments on marginalist economics. Text book versions of marginalism are discussed as well.

The economically learned people were educated as jurists in the late 19th century. The first independent chair of economic science was founded in the University of Helsinki in 1906. There were actually two communities of economics in Finland during that time. The Finnish-speaking society *Kansantaloudellinen Yhdistys* was founded in 1884 and the Swedish one *Ekonomiska Samfundet i Finland* ten years later. One can roughly say that most of the members of *Kansantaloudellinen Yhdistys* were strong supporters of the German historical school of economics. Many of the Swedish-speaking economists were supporters of economic liberalism. The circles of Finnish economically learned people were very small, authoritarian and not very tolerant and open to new ideas.

Jevosian economics was introduced to Finnish audience by Swedish economist *Gustaf Steffen*

(1864—1929) in the article called *Den nya riktningen inom Englands antionalekonomi* which was published in the journal *Finsk Tidskrift* in 1890.

The most important comments on marginalist economics were made by *Karl Willgren* (1865—1930) who wrote several articles about the theme. Willgren was interested especially in the Austrian version of marginalism. He published one review article on the Swedish economist *Knut Wicksell's* book *Über Wert, Kapital und Rente* as well. The Austrian economist *Eugen von Böhm-Bawerk* (1851—1914) received most attention among Finnish economists. *Karl Willgren*, the historian *Ernst Nevanlinna* (1873—1932) and the statistician *Oskar Groundström* were discussing von Böhm-Bawerk's ideas in their articles. One possible explanation for their interest in von Böhm-Bawerk's work is that the non-mathematical style of expression in Austrian economics and the perhaps most accessible writings of von Böhm-Bawerk made him popular among Finnish economists who were not familiar with mathematical expression. Besides that he cultural ties between Finland and German speaking countries were intensive. Many Finns traveled to Germany or to Austria to study economics.

Several text books of economics were translated into Finnish language in and after the turn of the century. In those text books marginalist economics was shortly introduced. The introduction, however, did not very clearly give an impression of a uniform and independent school of economic thought or a genuine theory break. One must remember thjat the independent teaching of economics as a separate discipline at the Finnish university was just starting.

Any independent marginal analysis was not presented by Finnish economists in the beginning of this century. The Austrian version of marginalism and especially the ideas of *Eugen von Böhm-Bawerk* were presented to the Finnish audience of

economically learned scholars and civil servants. French, English and Italian marginalists were presented as a »mathematical« school.

An interesting parallel to Finnish economics is Japanese economics in the turn of the century which despite of big differences had some similarities as well. Japan was an intellectual periphery and economics was imported from Europe. The Ger-

man historical school dominated Japanese economics strongly in the late 19th century. The German historical economics was opposed by *Tokuzo Fukuda* and his pupils who based their research on Marshallian, Jevonsian and Walrasian economics. So, unlike in Finland, in Japan marginalist economics became a part of the economic science soon after the turn of the century.