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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

REPORT AND RECOMMENDATIONS

of the

PRESIDENT

to the

EXECUTIVE DIRECTORS

Concerning a

SUPPLEMENTAL LOAN TO THE BANK OF FINLAND

October 27, 1952

### Currency Equivalents

US \$1 = 230 Fmk.

Fmk. 1 = 0.43 US Cents

Fmk. 100 million = US \$ 430,000

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REPORT AND RECOMMENDATIONS OF THE PRESIDENT  
TO THE EXECUTIVE DIRECTORS CONCERNING A  
SUPPLEMENTAL LOAN TO THE BANK OF FINLAND

1. Further to my report on Finland dated April 21, 1952 (R-585) I submit the following report and recommendations about an application by Suomen Pankki-Finlands Bank (the Bank of Finland) to increase the amount of the Bank's \$20 million loan of April 30, 1952 (Loan No. 61 FI) by 18 million Swedish kronor (equivalent to \$3.47 million).

PART I - HISTORICAL

2. During the negotiations preceding the loan of April 30, 1952 the Bank agreed to consider additional lending to Finland over and above the amount of \$20 million then under consideration, for additional purchases in Sweden, but only if this would place a Swedish kronor (and not a dollar) liability on Finland. Accordingly, the Bank asked the Swedish Government for a release of 18% currency. On March 21, the Swedish Government replied that it would be willing in principle to release up to SKr. 18 million for purchases of equipment for the Finnish woodworking industries. However, before finally agreeing to make this release, the Swedish Government would wish to have detailed specifications of the equipment required and an estimate of the cost. In view of the delay in obtaining the final Swedish decision, the Bank agreed, at the request of the Finnish Government, to complete the \$20 million transaction separately with the understanding that the additional Swedish kronor financing would be covered by a supplemental loan agreement.

3. In the course of the summer, agreement was reached between the Bank and the Finnish and Swedish Governments on the equipment to be financed under the supplemental loan. On October 6, Sveriges Riksbank notified the Bank that the Swedish authorities had formally approved the release.

4. The supplemental loan would bring the total of Bank loans made to Finland to the equivalent of over \$38 million, of which almost \$26 million equivalent would be for the woodworking industries and over \$11 million for electric power. The timber loan of \$2.3 million (No. 21 FI) has been repaid in full.

PART II - DESCRIPTION OF THE PROPOSED LOAN

General

5. The proposed loan and the \$20 million loan of April 30, 1952 are essentially two parts of the same transaction. The borrower would again be the Bank of Finland and the loan would be guaranteed fully by

the Republic of Finland. The supplemental loan would be in the amount of SKr. 18 million and would be used to finance the purchase in Sweden of equipment required for specific projects in the woodworking industries.

### Terms

6. Like the loan of April 30, 1952, the supplemental loan would be amortized by thirty semi-annual payments, of which the first would be due on December 1, 1955 and the last on June 1, 1970. The loan would bear interest, including 1% commission, at the rate of 4-3/4% per annum. A commitment charge of 3/4% per annum has been provided for.

### Legal Instruments and Authority

7. Drafts of the following documents are attached:

- a. Supplemental Loan Agreement between the Bank and Suomen Pankki-Finlands Bank (Annex I);
- b. Supplemental Guarantee Agreement between the Republic of Finland and the Bank (Annex II);
- c. Letter from the Bank of Finland about the terms on which the funds received would be re-lent to the companies carrying out the projects, about the business experience and financial soundness of those companies, and about their sources of financing supplementary to the Bank's loan (Annex III).

8. Annex IV contains the report of the committee provided for in Article III, Section 4, subsection (iii) of the Articles of Agreement.

9. The Agreements incorporate all the relevant provisions of the Loan and Guarantee Agreements relating to the \$20 million loan. The description of some of the woodworking industries projects has been amended to include equipment financed under the proposed supplemental loan. In addition, the new agreements provide that an event of default under the \$20 million loan would constitute a default under the Swedish kronor loan and vice versa.

10. The funds borrowed from the Bank would be re-lent by the Bank of Finland to the various companies which would carry out the projects. The terms and conditions of these subsidiary loans would be substantially the same as those contained in the Supplemental Loan Agreement between the borrower and the Bank. The Bank of Finland would obligate itself to provide the remaining currencies needed if they should not be otherwise available.

11. The Finnish Diet has enacted legislation authorizing the Ministry of Finance to grant the Government's guarantee for foreign loans contracted by the Bank of Finland up to an aggregate amount sufficient to cover the proposed loan.

PART III - APPRAISAL OF THE PROPOSED LOAN

12. The following table shows the manner in which the proceeds of the supplemental loan would be distributed among the various companies and the amounts already allocated to these companies under the \$20 million loan.

<u>Company</u>	<u>Proposed Allocation</u> <u>under Supplemental Loan</u>		<u>Allocation under</u> <u>Loan No. 61 FI</u>
	<u>SKr.</u>	<u>\$ equivalent</u>	<u>\$</u>
Oulu	7,000	1,351	310
Joutseno	3,700	714	560
Veitsiluoto	2,000	386	700
Kemi	1,850	358	700
Pietarsaari (Jakobstad)	1,750	338	17
Serlachius	1,100	212	-
Toppila	150	29	40
Saastamoinen	100	19	31
Metsanomistajain Metsakeskus	350	68	-
	<u>18,000</u>	<u>3,475</u>	<u>2,358</u>

13. SKr. 16.55 million or over 90% of the supplemental loan would be used by companies which obtained funds under the loan of April 30 and would be spent by them on the same projects as those previously financed by the Bank. Their building programs are not affected and the only change resulting from the supplemental loan would be that the Bank would provide funds which would otherwise have come from the none too plentiful reserves of the Bank of Finland.

14. The appraisal of the woodworking projects in Part III of my Report of April 21 and in Annex V to it, "Technical Report on the Power, Woodworking and Agricultural Projects", therefore covers almost all the projects now under consideration. About two-fifths of the supplemental loan would be for the Oulu project, which received a relatively small part of the \$20 million loan and was therefore not described in detail in the technical report submitted in April. The project is aimed at increasing the capacity of the company's already large chemical pulp mills from 90,000 to 150,000 metric tons annually. For this purpose the Bank would finance the purchase of a variety of equipment including a soda recovery boiler, evaporators, a blow tank and condensers.

15. Serlachius and Metsanomistajain Metsakeskus are the only two companies whose projects were not included in the \$20 million loan. Serlachius is a large company which received about \$2 million of the Bank's \$12.5 million loan of August 1949. Under the supplemental loan it would purchase power generating equipment for its three mills producing paper board. Metsanomistajain Metsakeskus is an established company engaged in sawmilling; it would purchase machinery to expand and modernize its operations.

PART IV - RECENT ECONOMIC DEVELOPMENTS IN FINLAND

16. A report on "The Creditworthiness of Finland" was submitted to the Executive Directors on February 11, 1952 (R-561). Since there have been some striking economic developments in Finland in 1952, these are considered briefly in the following paragraphs.

17. When the \$20 million loan was signed it was already evident that the abnormal boom in timber products was coming to an end. Since then the change in the export market has been as dramatic as the upswing which preceded it. By the middle of 1952, Finnish export prices had dropped by close to 40% from the peak levels reached at the end of 1951. With foreign consumers preferring to run down their stocks at least until the price fall had run its course, the volume of Finnish exports also declined. On the other hand the volume of imports was at a record level. Since strict import controls were not imposed until March and import prices showed only a slow downward trend, there was a trade deficit equivalent to over \$110 million in the first eight months of 1952 compared with a trade surplus equivalent to about \$65 million in the first eight months of 1951. The disequilibrium now appears to have been brought under control - there has been some recovery in timber prices in recent weeks and there was a small surplus on trade account in August - but the delay in tightening import controls has cost Finland a substantial part of the foreign exchange reserves she accumulated in 1951. If exports do not recover as expected, the position will be strained in the coming months.

18. The last deliveries of reparations to the Soviet Union were made in September, so that the whole indemnity was paid off within the specified time. The end of reparations, however, brings difficult problems for Finland, since over 70% of the goods delivered came from the shipbuilding and engineering industries, the capacity of which had been more than doubled at great cost for the express purpose of making the deliveries possible. To find markets for the products of these industries will not be easy since in these sectors Finnish costs are often high. Commercial agreements have been made with the Soviet Union providing for the export of certain of these products in return for various essential imports such as grain, oil, steel, and fertilizers, and also coal from Poland. Some goods have also been sold in other countries but so far commercial exports have done less to bridge the gap in demand for the products of these industries left by the end of reparations deliveries than have domestic sales. The importance of finding markets for these industries is indicated by the fact that they now give work to some 80,000 people.

19. Although output has dropped sharply in recent months, notably in the export industries, unemployment has not been serious so far. At the same time the lower world market prices have supported the Government's stabilization efforts. From their peak in November 1951 wholesale prices have declined about 10% and are now back almost at the level prevailing in the spring of 1951 when the export boom got under way. The cost of

living index has been practically constant throughout 1952 and no general wage rises have occurred since February 1951. As a result of the recent imports, the country must be better stocked than at any time since the war. The money supply has remained fairly constant; savings have increased and the expansion of domestic credit has more or less offset the decline in foreign exchange reserves. So far, public revenue and expenditures have been balanced this year, but it is likely that 1952 will close with an overall deficit. In the budget estimates for 1953 both revenue and expenditure are somewhat higher than in 1952 and net borrowing from the public of 6 billion marks (equivalent to \$26 million) is required to achieve balance. The end of reparations has thus not brought any lightening of the taxpayers' burden for in the light of the less favorable export position the Government has considered it necessary to provide increased funds for public investment. The danger of inflation has receded in the past year - indeed, unemployment could quickly become an important political problem this winter - but the continuing high rate of investment, the probable budget deficit and the existence in the hands of the public of large liquid assets indicate that inflationary elements still persist. ?

#### PART V - PROSPECTS FOR FULFILLMENT OF OBLIGATIONS

20. Finland normally shows a deficit in her bilateral payments with Sweden. In the last three years, it has averaged more than \$10 million equivalent. Her imports include a substantial volume of capital goods, but most of her exports are goods which Sweden herself exports and the sale of Finnish roundwood for processing in Sweden seems likely to decline as the Finnish woodworking industry expands. Finland also has a deficit with Sweden on account of invisibles and in the coming years this will be swollen by payments on the Finnish debts incurred during and after the war. Scheduled annual amortization payments on the Finnish public external debt payable in Swedish kronor average only about SKr. 4 million (\$770,000) through 1958 but thereafter rise to almost SKr. 17 million (\$3.3 million) in 1959 and to almost SKr. 23 million (\$4.4 million) in 1973. The proposed loan will add only SKr. 1.7 million (\$330,000) to these annual payments. Apart from the war and immediate postwar years when she borrowed heavily from Sweden, Finland has used surpluses earned in trade with other areas to meet her current account deficit with Sweden. Before the war sterling was widely used for this purpose. Finland's sterling position is at present somewhat strained but on the whole the surplus with the sterling area has re-appeared. Finland has already made considerable use of sterling to meet deficits with other countries since the war and should be able to do so in the future.

21. As I stated in my earlier report, Finland should be able to balance her accounts with the rest of the world at a level of trade high enough to service her external debt including the proposed loan. The recent fall in timber and pulp prices should be discounted somewhat since it was a decline from the abnormally high levels reached at the end of 1951. The fall has been greatest in pulp and more normal ratios now prevail among pulp and paper prices. There is a strong upward trend in demand for pulp and paper products and the long run prospects for their sale are favorable. Provided

that she is successful in preventing a further rise in production costs from affecting her competitive position, Finland can be expected to maintain her position in the world market for timber, pulp and paper products.

PART VI - COMPLIANCE WITH ARTICLES OF AGREEMENT

22. I am satisfied that the proposed loan complies with the requirements of the Articles of Agreement of the Bank.

PART VII - RECOMMENDATIONS

23. I recommend that the Bank at this time grant to the Bank of Finland with the guarantee of the Republic of Finland a loan of SKr. 18 million or the equivalent in other currencies for a total term of 18 years, with interest (including commission) at the rate of  $4\frac{3}{4}\%$  and commitment charge at  $\frac{3}{4}\%$ , and on such other terms as are specified in the form of Supplemental Loan and Guarantee Agreements attached hereto.

Eugene R. Black  
President

Washington, D. C.  
October 27, 1952