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Pekka Sutela


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Bank of Finland

Institute for Economies in Transition, BOFIT

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Bank of Finland
Institute for Economies in Transition (BOFIT)

PO Box 160
FIN-00101 Helsinki
Phone: +358 9 183 2268
Fax: +358 9 183 2294
bofit@bof.fi
www.bof.fi/bofit

Pekka Sutela

# Clearing, Money and Investment: The Finnish Perspective on Trading with the USSR[1]

## Summary

This paper gives an overview of the Finnish experience of trading with the USSR as well as perspectives regarding trading with Russia. In particular, it is asked whether trade with the USSR was exceptionally profitable to Finnish export companies and whether the collapse of the Soviet market in 1991 was a prime factor in to the unprecedented decline of the Finnish economy in 1991. Finnish views and expectations concerning trade and direct investment in the future Russia are also discussed. The paper concludes with some possible lessons to be learned from the Finnish experience that may apply to any eventual clearing arrangements in trade between the former Soviet republics.

[1] To appear in **Russian and East European Finance and Trade** (Leuven), Winter 1992-1993. Earlier versions of this paper were presented at the 91th Integration Symposium of the Confederation of European Associations of Economists in Urbino, October 1991 and at Oxford University, January 1992. In addition to the organizers and participants of these seminars, thanks for information and comment are due to Sergey Alexashenko, Kari Holopainen, Kamil Janacek, Ilkka Kajaste and Jouko Rautava. The opinions expressed in this paper are those of the author and do not necessarily reflect the views of the Bank of Finland.

# 1 Introduction[2]

Trading with – and in particular exporting to – the Soviet Union was traditionally seen by many in Central and Eastern Europe as a burden to be minimized. It created undesirable dependence, strengthened through its reliance on government-level negotiations the role of state bureaucracies in the economy and furthermore tied up scarce resources in production which more often than not failed to meet world market productivity and quality requirements. On the other hand, one of the explanations often put forward for the relative success of the Finnish economy in the postwar period has been the apparent benefits derived from its trade with the Soviet Union. Assuming that both attitudes are based on facts, an obvious question arises: how can trade with the USSR have been both a bad thing (for Eastern Europe) and a good thing (for Finland)? To contribute towards an answer, this paper discusses some of the peculiarities of Finnish exports to the USSR.

Another question arises now after the collapse of the Soviet market in 1991. In retrospect, were both Eastern Europe and Finland too dependent on trade with the USSR? In particular, how did the decline in Finnish exports contribute to the USSR to the 6.2 percent decline in Finnish production in 1991, which was unprecedented for a post-WWII developed market economy? How do Finnish authorities and business people see the possibilities for trade and economic cooperation with the Russia of the future?

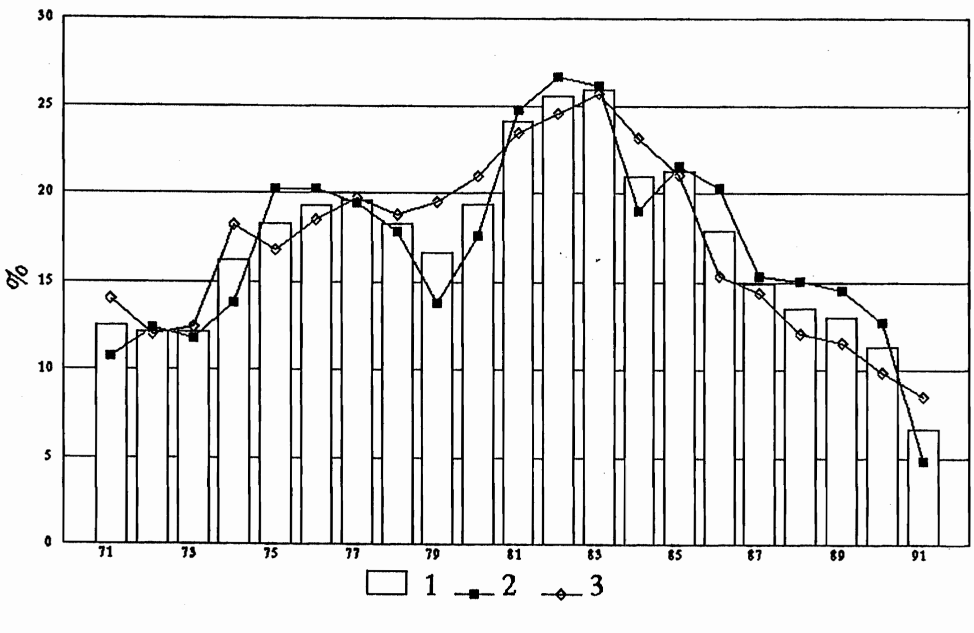
[2] The first part of this paper draws on Sutela (1991a).

## 2 Finnish Exports to the USSR

Finland's trade with the USSR was unique among developed market economies in two respects.[3] It is the only country of its kind for whom the USSR has, at least temporarily, been the most important trading partner. While the Soviet share of Finnish exports has traditionally been around 15 percent,it expanded along with the rise in energy prices and peaked at over 26 percent in 1982. Since then, the share has declined, and was about 14 percent in 1989 (see Figure 1).

This trend, though at the time deplored by many in Finland, implies that Finnish exports had already to a large extent adapted to the decline of Soviet demand when it became conspicuous in 1990 and finally collapsed in 1991. It is in retrospect fortunate that – contrary to many suggestions – Finnish trade authorities did not in 1988-1990 undertake further financing or other related measures to maintain the traditional Soviet share in Finnish exports. The 1991 collapse in exports could have been even worse, leaving in its wake more unemployment and outstanding credit than is the case now. The underlying analysis of Finnish policy-makers seems to have been vindicated.

Figure 1. **The Soviet Union's share in Finland's Foreign Trade in 1971-1991**

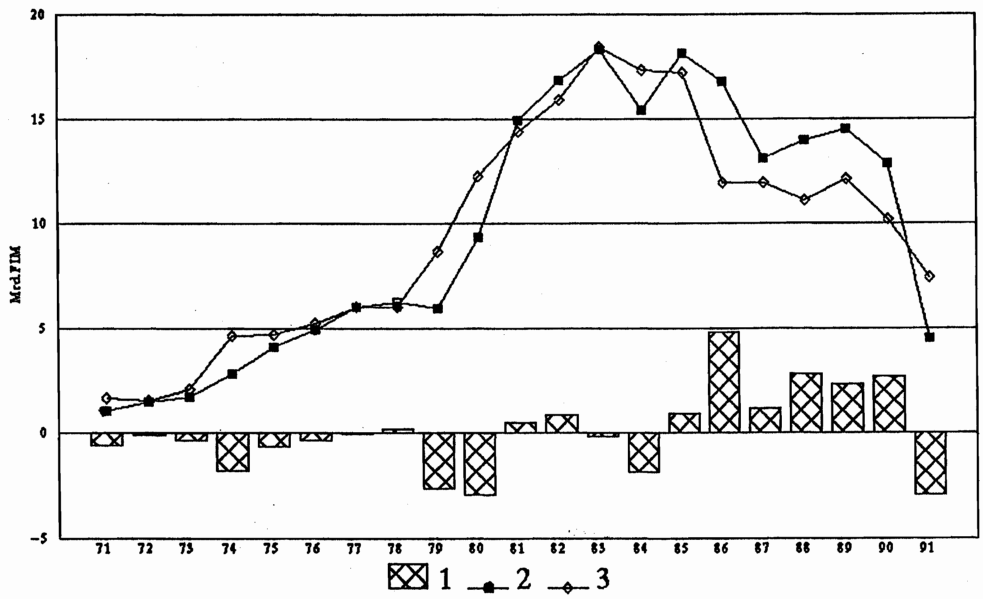



1 Turnover
2 Exports to the Soviet Union
3 Imports from the Soviet Union

[3] The only available general introduction to the traditional mechanisms of Finnish-Soviet trade is Möttölä et al (1983). Also see Oblath - Pete (1990).

The Soviet share in Finnish exports declined further in 1990 to about 10 percent and then to 5 percent in 1991. After having declined by 11.1 percent in 1990, the value of Finnish imports from the USSR declined by 27 percent in 1991 while exports collapsed by 65 percent.[4] This is substantially more than the overall decline in Soviet imports and, in particular, much more than the decline in Soviet imports from the traditional convertible currency area. Indeed it seems likely that Finnish exports to the USSR declined in 1991 faster than those of any other major trade partner. Only the Eastern European countries are comparable in this respect.[5] Finland's share of Soviet imports from the OECD area can be estimated to have dropped from 9 percent in 1990 to about 4 percent in 1991 (Rautava - Hukkinen, 1992). The trade balance, traditionally in Finland's favour, turned into a deficit figure 2).

Figure 2. **Finnish - Soviet Trade in 1971 - 1991**




1 Trade balance
2 Exports
3 Imports

It seems natural to assume that the change in the trading regime contributed to the exceptional collapse of Finnish exports to the USSR. Yet, even the present Soviet share in Finnish exports is notably high for developed market economies.

However one should not jump to conclusions here. It is presumably true – though we cannot be sure – that the existence of the clearing arrangement meant

[4] In early 1991, the most common guesstimate for the decline in exports to the USSR was "only" 40 percent. See Sutela (1991a).

[5] According to preliminary data, the 1991 volume changes in the exports of Eastern European countries to the USSR ranged from - 57 percent for Bulgaria to - 74 percent for Poland.

that Finland had a special niche in Soviet foreign trade planning. However that as such in no way implies that the planned Finnish trade share would necessarily have been larger than "normal". Clearing could also have been used to discriminate against trade with Finland. But in fact that was not the case, and clearing arrangements must be seen as a vehicle for implementing politically ordered priorities. In this sense, thus, the collapse of trade was not a consequence of the abolishment of clearing, but rather of the abrogation of those political decisions that had previously given Finland a high priority in the USSR's foreign trade with the West.

Unfortunately, there appear to be no studies available concerning the 'natural' level of Finnish-Soviet trade.[6] In a rational world, the factors of size, proximity and resource endowments would undoubtedly imply a relatively high share for the USSR in Finnish exports. It is therefore not evident whether the high level of past or present trade shares is normal or abnormal.One thing that is clear, however, is that, because of limitations on market access, the USSR has been trading with Finland in goods such as textiles, footwear and foods, for which the latter is not a major world market supplier.[7]

Due to the peculiarities of clearing trade to be discussed below, Finnish exporters have been eager to supply the USSR. These factors also imply that when Russian trade relations with major world market competitors started to normalize and the clearing trade system between Finland and the USSR was abolished the mutual foreign trade shares of Finland and the USSR were bound to be lower than those reached in the 1980's. No wonder, then, that many Finnish exporters campaigned for the preservation of the clearing system in 1990.

Furthermore, the cost level of Finnish industries increased rapidly in the late 1980's. Since 1985 Finland has been rapidly losing market share in the major Western countries. The changed emphasis in Soviet foreign trade decisionmaking from political to economic criteria, which was also reflected in the abolishment of the clearing arrangement, implied that these negative factors together would reduce Finnish market shares in the Soviet economy.

In 1990 Finland was the only developed market economy still trading with the USSR on the basis of bilateral clearing.[8] Given the relative sizes of the economies, the value of Finnish exports under this arrangement was effectively constrained by Finnish imports from the USSR, in practice by Finnish absorption, Soviet availability and world market prices of Soviet energy, primarily crude oil, which used to make up the bulk of Finnish imports from the USSR (see Figure 3).[9] In this

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[6] During the last 130 years the share of Russia/Soviet Union in total Finnish exports has varied between 95 percent (during WWI) and zero (during WWII). In the interwar period, trade hardly existed, and after WWII the share fluctuated generally between ten and twenty percent. For obvious reasons these figures imply very little if anything about natural trade levels.

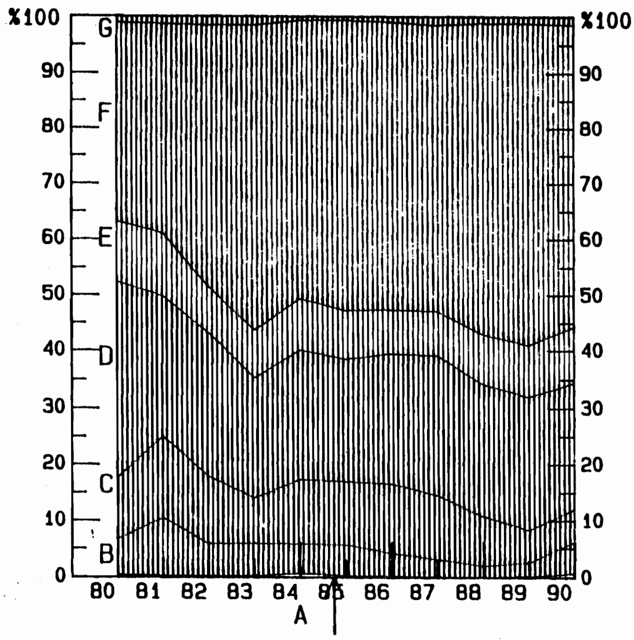
[7] Some such Soviet imports from Finland in the late 1980's were even paid in currency and cannot therefore be explained by the peculiarities of bilateral clearing trade.

[8] As will be seen below, by 1989 clearing was in fact already moving rapidly towards normal currency trade.

[9] In 1989 Finland imported 94 percent of its crude oil from the USSR. In 1991 the share dropped to 34 percent, and it is expected that in 1992 the share will be around 20 percent. The end of clearing trade, more stringent environmental standards and, of course, Russian supply problems have

respect Finland's trade with the USSR was basically similar to that of the East European countries in so far as it has been bilaterally balanced.

Figure 3.1 **Structure of Trade 1980 - 1990**
**Exports by industries**




A Agriculture and forestry
B Food, beverages and tobacco
C Textiles, clothing and leather
D Wood products, paper and pulp
E Chemicals
F Metal and engineering
G Other articles

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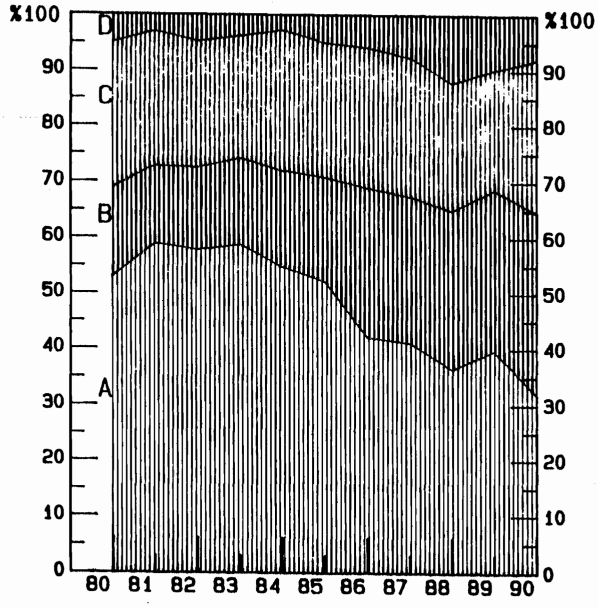
all contributed to this development. Transportation logistics, especially the wintertime need for tankers especially built for ice-covered seas, would still tend to make Baltic harbours natural supply sources for Finnish crude oil imports.

Figure 3.2 **Imports by use of goods**




A Crude oil
B Other raw materials
C Fuels and lubricants
D Investment and consumer goods, etc.

In reality, Finnish-Soviet trade has not been nearly as tightly fettered as the need for balancing the clearing account would seem to imply. As the volatility of energy prices increased, making the mechanical balancing of payments difficult, various financial arrangements were developed so that trade volumes would not fluctuate as much as energy prices. In fact, by the latter half of the 1980s, such arrangements, as alien as they are to the basic philosophy of clearing trade, covered the larger part of Finnish-Soviet trade, although they in fact failed to stabilize trade volumes. Exports to the USSR continued to fluctuate much more than overall exports (see Figure 4).[10] The share of outright currency trade in total turnover also increased rapidly, reaching a level of about one-third[11]. This is an interesting topic in its own right but not crucial for the arguments of this paper.

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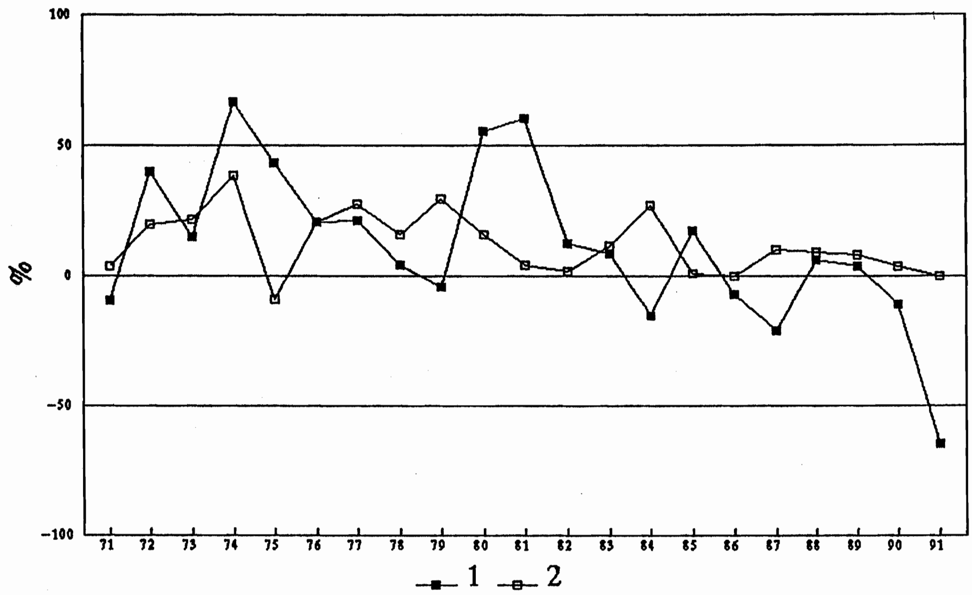
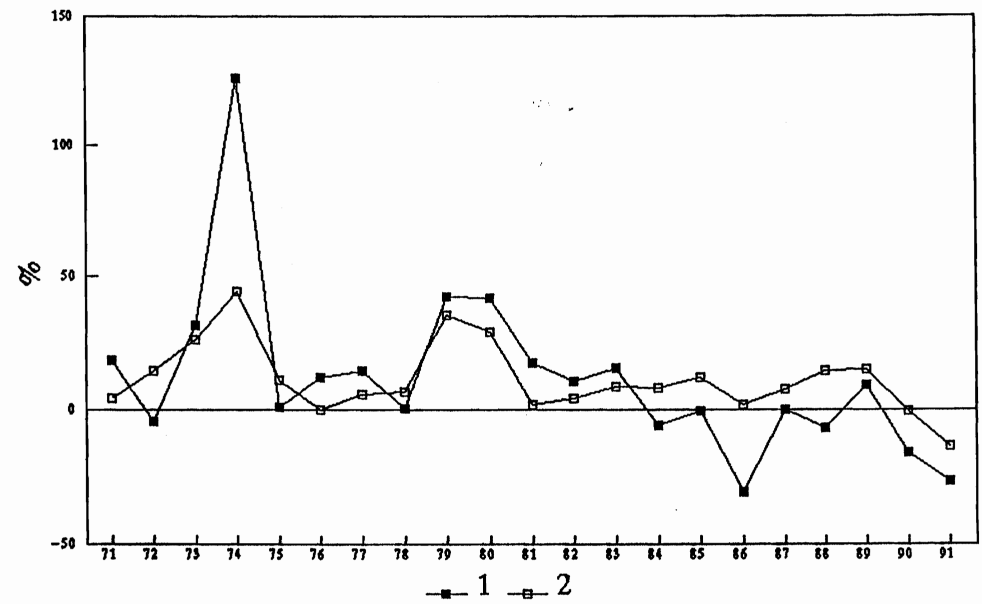
[10] Figure 3 also shows the countercyclical pattern of exports to the USSR, much discussed in Finland. While oil price shocks sent Western markets into depression and thus decreased overall Finnish exports, they tended - through bilateral balancing - to increase Finnish exports to the USSR. While the terms-of-trade effect was similar in both markets, the volume effects of oil price shocks differed. In Figure 3, this is evident for 1975-1990 and may arguably have been a major factor behind the exceptionally long Finnish boom of the 1980s. In the 1980s, the trade mechanism was also purposely used as a countercyclical policy tool (see Kajaste, 1992).

[11] For a compact discussion of the trends up to late-1990 see Kivilahti - Rautava (1990).

Figure 4 **Finland's Foreign Trade in 1971 - 1991, percentage change from previous year**




1 Exports to the Soviet Union
2 Other exports




1 Imports from the Soviet Union
2 Other imports

# 3 Soviet trade in the Finnish economy

In spite of its obvious economic importance and inherent interest, the bilateral trading system has been relatively neglected in Finnish research[12]. One reason for this is the fact that trade with the Soviet Union used to belong to the integral core of Finland's corporatist political economy. Though state trading with the USSR was embedded in the overall market economy framework of Finland, in fact this aspect of the Finnish way of doing business is even more highly concentrated and politicized than is the economy at large[13]. More than half of all Finnish imports from the USSR used to be handled by a single company, the state-owned oil and chemical corporation Neste. Exports have also been highly concentrated.

In 1989 the total number of Finnish exporters to the USSR was 1688 (Sutela (1991a)). The five largest exporters accounted for 39.9 percent of all exports, the fifty largest for 78.7 percent and a total of 116 exporters for 90 percent. Such concentration is clearly higher than in overall Finnish exports.[14]

Looking at the matter from the Soviet side, such concentration of Finnish export activities can be explained by the scale preferences of the specialized Soviet importers. In the Finnish perspective, two partially competing explanations for this state of affairs seem possible. Concentration may be due to the fact that the main proportions of trade used to be agreed in five-year framework protocols. Though these agreements were solemnly concluded between states, on the Finnish side they were prepared, negotiated and accepted by (in most cases privately owned) profit-maximizing enterprises. Such lengthy planning horizons, though entailing only rather loose quotas which were later flashed out in commercial contracts, may well have exceeded the possibilities of small companies. But on the other hand, the centralized system of conducting bilateral trade through governmental commissions and associations of industries may as such have made large corporations policy-makers and insiders privy to both essential information and contacts.[15]

Thus shrouded in the twin mysteries of business and politics, Finland's trade with the USSR has traditionally been regarded with some scepticism by large sections of the public. The bilateral trading system, in particular, has been widely seen as something strange, alien to the spirit of a market economy and therefore probably economically disadvantageous to Finland. This paper leaves aside the mac-

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[12] For a first attempt at an economic analysis, see Alho et al. (1986).

[13] For a general analysis of Finnish social corporatism in a comparative framework see essays in Pekkarinen et al. (1992).

[14] Thus, the share of the ten largest exporters to the USSR in 1989 was 51 percent, in all exports 42 percent.

[15] For a well-informed outside view of the Finnish-Soviet trading mechanism see Oblath - Pete, 1990.

roeconomic effects of bilateral trading.[16] The intriguing issue of exchange rates will also be sidestepped (see Sutela, 1991a).

On the micro level, the view of bilateral trading as being inherently disadvantageous to Finland is not supported by Finnish business opinion. A 1983 survey of companies in light industry found that 66 percent of them believed that exports to the Soviet Union were marked by greater-than-average profitability (Kivikari, 1985). A 1990 survey found that most companies interviewed opposed the Soviet-proposed changeover from bilateral clearing to conventional trading based on convertible currencies (Koivumaa - Valtonen, 1990). And in Autumn 1990, this was the view consistently expressed by the associations of Finnish industries. It may thus have been the case that exporting to the USSR was particularly profitable and that this had something to do with the clearing mechanism. This then is the main subject of this paper.

[16] But perhaps it is appropriate to note that the observations just offered also provide insight into the kinds of industrial policies that have been cited to explain the fact that the capital intensity of Finnish exports to the USSR seems to have been higher than warranted by Heckscher-Ohlin considerations. See Hellvin - Torstensson (1991).

# 4 Were Soviet prices higher?

In spite of general adherence to the principle of using world market prices as the pricing base in Finnish-Soviet trade, one can conceive of ways in which the prices of Finnish exports to the USSR might have been higher than the corresponding prices elsewhere. The first – and perhaps relevant – case would arise if the clearing rouble had been relatively cheaper to Soviet importers than convertible currencies. This is not inconceivable, as the maze of Soviet foreign trade financial regulations was always notorious, and the Soviet authorities may have had a political reason for such pro-Finnish discrimination. There is, however, no information upon which to either confirm or reject this possibility.

Furthermore, one might at least theoretically consider a peculiar Finnish form of industrial subsidy. Assume that the Finnish authorities decided for some reason to support those industries which currently exported to the USSR. One way of doing this would be to pay higher prices than those currently charged on world markets for oil and related imported products on the understanding that a similar surcharge would be added to Finnish export prices. In this (obviously purely hypothetical) case the Finnish importer, a state-owned monopoly, would be compensated through consumer prices. Administering such a hypothetical arrangement, however, would probably prove to be quite difficult and there is no firm evidence that it has been used.

One can also conceive of other ways in which the Finnish state might have used trade with the Soviet Union as an industrial subsidy. Finally, the possibility should not be excluded that, at least during some periods, Soviet officials have simply negotiated bad contracts, either because of incompetence, the ready availability of earnings from energy exports or because of their notoriously soft budget constraints. Other possible reasons could also be given.[17] World market prices to be used as references in trade negotiations are not easily defined for most commodities.

It is obvious that in some ways Finnish-Soviet trading arrangements used to be peculiarly advantageous to Finnish exporters. As a somewhat extreme but important example consider the payment arrangement for Finnish-built ships which held sway until the early eighties. Under this arrangement the buyer paid up to a quarter of the value of the deal when it was agreed or when work commenced, sometimes years before the ship was delivered. By the date of delivery, the ships were already fully paid for. This, of course, was in sharp contrast with the conventional practice of export financing and provided profitable opportunities for financial management by Finnish shipbuilders.

All of this must remain a matter of speculation, as the actual export prices paid are, of course, business secrets. However some can be shed on this matter by unit value indices which can be derived from commodity export statistics. Assuming that structural and quality changes are negligible (over a sufficiently short period of time), changes in unit values are indicative of changes in prices. **Kajaste** and **Mattila** (1988) have calculated (also see Kajaste, 1992) that following the increase

[17] One potentially interesting case is the enterprise-specific buy-back arrangement known as "industrial cooperation" that became widespread in the 1980's. Quite probably, these arrangements tended to increase price levels, but the burden was not necessarily evenly distributed.

in Soviet export earnings and the strengthening of the rouble in the early 1980s, the unit values of Finnish exports to the USSR rose faster than those of other Finnish exports in such major sectors as the food industry, light industry, the paper and forestry industries and the engineering industry. This did not, however, take place in the basic metals or chemical industries.

These calculations are consistent with the view that Soviet importers have had a tendency to be liberal with money when it is plentiful. Still, they only refer to changes in the unit values of exports, and do not necessarily reveal anything about relevant price levels.

To obtain such information, one could look for homogenous commodities which are exported to different markets. The choice is of necessity somewhat arbitrary, and the volumes exported to different markets fluctuate. But taking the examples of eleven commodities, ranging from newsprint to polyester-based alkyd paints, one does find some corroborative evidence for the view that Russian markets have provided a profitable outlet at least when energy earnings have been profitable.[18]

In seven cases out of eleven the price paid by the USSR in 1985, when Soviet energy income was high, was the highest for any market. In no case was it the lowest, and in the two cases where the USSR market was among the three lowest-paying, the volume exported to the Soviet Union made up the bulk of Finnish total exports. Economies of scale may thus have compensated for the lower prices. In the interesting case of newsprint, for which the USSR is a relatively small market, the prices obtained in different markets vary only a little, and the USSR was among the top two customers in 1980, 1985 and 1989.

In 1989, when Soviet export earnings had dwindled, the USSR paid the highest unit prices in only three of these eleven cases. In each of these cases the market in question was relatively small. In five cases the Soviet price was the second highest, and in no case was it the lowest.

In addition to such quasi time-series, more detailed information is available on the prices obtained for exports to the USSR and Western markets in 1985 (Kajaste, 1992). As noted above, that year is of particular interest, as the very sketchy information cited above seems to imply that the Russians were liberal with their money when oil prices were high. This view is loosely corroborated by data on the prices of 250 export items (46 percent of the value of exports to the USSR). On average, the prices of exports to the USSR were 109.5 percent of prices of exports to the West. For about 60 percent of exports to the USSR prices were higher than those received in Western markets. The difference was about one fifth in non-metallic minerals and foodstuffs. In forestry exports the difference was about 16 percent and in engineering, textiles and clothing exports somewhat more than 10 percent. On the other hand, the export prices of chemicals and metals were lower than for exports to the market economies.

According to **Kajaste** (1992) "these results seem to support the commonly held view that exports to the Soviet Union were exceptionally profitable during the 1980's". But words of caveat are in order. First of all, this data concerns only one

[18] The commodities in question are newsprint, women's shoes with leather uppers, a particular class of tights, polyester-based alkyd paints, men's and boys' pants, men's and boys' woollen suits, women's and girls'jackets, sports shoes, parquet, car tyres and combined refrigerator-deepfreezers. This information was culled from customs statistics by Mr. Ilkka Kajaste.

year, 1985, a year when oil prices were high and hence Soviet export revenue was plentiful. Perhaps more importantly, on this disaggregated level the relative price of exports to the USSR varied between 50 and 200 – even after 103 items of the original 353 had been eliminated as outliers. Such variation is surely more interesting than the average price differential of 9.5 percent.

These indicators are obviously far from conclusive. The sample used in the quasi time-series is a small one, and commodities assumed to be homogenous may in fact be quite heterogenous. For 1985, the high variability of relative prices is at least as noteworthy as the fact that on average Soviet buyers apparently did pay better prices than others. Furthermore, price is only one side of profitability. One should also look at the costs of finance, marketing, other transaction costs – including transportation, obviously an important factor for Finland – and possible differences in production costs.

## 5 Profitability levels

No direct evidence is available on the market-specific profitability of Finnish exports. Finnish companies have traditionally been very protective about their own financial data. The discussion above indicates that on average the prices obtained in the Soviet market have clearly not been less than those available elsewhere. Ultimately, the most important factor in so far as Finnish exporters were concerned may have been the way in which bilateral trade has been financed. Though the Bank of Finland incurred quite high costs in the 1980's as a result of the mostly interest-free financing of Soviet deficits within the clearing system, no such direct costs were incurred by individual companies.[19] On the contrary, the convention of prepayments formerly applied in selling ships must have been extremely convenient for Finnish exporters, operating within a rapidly developing and somewhat abruptly liberalised domestic financial environment. Even after the payment arrangement for ships was changed, trading through the clearing account has actually been equivalent to cash trade for the exporting firms.

It would not seem unrealistic to conclude that this factor – certainly exceptional in modern international trade – has probably been the foremost reason for the Finnish exporters' preference for clearing.

By 1989-1990, however, these peculiarities of Finnish trade with the USSR were fast disappearing. As already noted, the share of currency trade increased, various financing arrangements were normalized and a totally new element, rouble exchange rate uncertainty, also emerged. Though transition away from clearing might have begun to seem inevitable, the old ways of trading were still viewed with favour.

Furthermore, there are transaction costs to consider. The highly structured, bureaucratic way in which trade has been conducted with the USSR has meant that those firms with long traditions have had a significant sunk cost element in their total transaction costs. In particular, as long as trade was conducted with a single Moscow-based ministry and foreign trade organization, marginal transaction costs may well have been less than those encountered in other markets, and the fixed costs may have been compensated for by the lesser degree of uncertainty brought about by traditional contacts and long-term governmental contracts. All this however remains speculation.

As already noted, relatively few Finnish firms exported to the USSR. Accordingly, average shipments probably tended to be larger and economies of scale greater than in other trade. This is cited by Finnish exporters as one of the most important advantages of selling to the USSR (Koivumaa - Valtonen, 1990). Even here, no quantitative evidence is available. The same is true of the possibly less stringent quality requirements of Soviet buyers. However, in what is probably the only study directly related to the relative profitability of exporting to the USSR (Tolonen, 1985), the conclusion is drawn that in general there is no significant

[19] An unpublished Bank of Finland study (Rautava, 1988) concluded that the interest costs incurred by the Bank in 1981-1987 as a result of the interest-free crediting of Soviet deficits in the clearing account amounted to FIM 1.4 - 2.5 billion (USD 380 - 675 million, 1990 rate of exchange). An interest rate was duly introduced later.

difference in the profitability of exporting to the USSR or elsewhere. The most interesting years in this respect are probably the mid-1980s, which are not covered by Tolonen, whose study only goes to 1981.

Mention should also be made of the effects of exchange rate changes. Soviet export earnings were large in the early 1980s not only because of higher oil prices, but because the dollar's value relative to the Finnish markka almost doubled between 1980 and early 1985. After that, the dollar declined almost as rapidly until late 1987. The rouble was then tied to a basket of currencies in which (in late 1983) the share of dollar was 42 percent (Oksanen, 1984). Consequently, the rouble followed the dollar,rising by about 30 percent between 1980 and late 1982. After that, its rate of exchange against the Finnish markka remained relatively stable, declining between 1985 and 1990 by much less than dollar did.

Soviet exchange rate policy was never well understood. However, the result of the appreciation of the rouble in the early 1980s is clear. Finnish industries, such as shipbuilding and construction, whose trade with the USSR rose sharply in the late 1970s, must have benefitted substantially from their long-term contracts quoted in roubles. The share of building projects, for example, in total Finnish exports to the USSR fluctuated at the time between 10 and 15 percent. The best known project, the Kostamuksha mining combine in Soviet Karelia, was built in 1977-1985 for the total price of about USD 1.5 billion (current price, 1990 rate of exchange). When asked by a journalist about the profitability of the project, the main contractor claimed that without the changes in the exchange rate it would have been a loss-maker because of higher than expected cost increases in Finland, but in fact it brought in "a lot" of money (Keskinen, 1987, p. 356).

## 6 Relative competitiveness

Two hypotheses have been tested in the Finnish literature concerning the effects of trade with the Soviet Union on the general competitiveness of Finnish companies. First, one can argue that the competitiveness of Finnish companies in the world market has been enhanced by the protected position they enjoyed in the Soviet market because of the clearing system. This **stepping stone effect** refers to the fact that the Soviet market acts as a stepping stone for new and expanding firms. Secondly, there may be a **survival effect,** as protected exports to the USSR enable old and no longer competitive companies to survive.

Early studies on these hypotheses were less than conclusive. **Tolonen** (1985) concluded that the stepping stone effect can only be assumed in the case of shipbuilding. **Kivikari** (1985) found no stepping stone effect in the light industries studied. The companies exporting to the USSR had originally expanded in the Western markets. As regards the survival effect, Tolonen found evidence for it only with respect to the paper industry, and Kivikari found no trace of it in the light industries.[20]

Only a few years later, **Kajaste** and **Mattila** (1988) argued that Finnish export production structures had in fact become so specialized that in many cases there was no simple way of compensating for declining Soviet exports by increasing exports to the Western markets. This was a harbinger of things to come.

In a recent study, **Hukkinen** (1990) points out that Finland's market share in the USSR doubled in 1970-1981, thanks to the joint effect of Soviet oil revenue and the clearing system. Since then, the Finnish market share has declined. In fact, already in early 1990 it fell to the level it had reached before the second oil crisis. Since then, as seen above, it has deteriorated further. The seeds of decline were imbedded in the earlier success.

In 1970-1986, the structure of Finnish exports to the Soviet Union was the most rigid of all OECD countries. While the shares of metals, industrial equipment and special-purpose machinery increased the most in total Soviet imports from the West, Finnish companies increased their market shares in such traditionally-traded commodities as ships, clothing, pulp and paper, and footwear. In general, these seem to be sectors where the unit values of exports to the USSR increased faster than those in other Finnish exports. There is also some indication that in the mid-1980s the prices obtained in exporting such products to the USSR were higher than those obtained elsewhere.

Overall, the Soviet market therefore may have provided a false sense of success and security through advantageous pricing of traditional Finnish export commodities. At the same time, the share of exports in total Finnish GNP declined and the structure of exports actually grew more traditional and one-sided. The country grew fat and lazy first by selling its traditional goods and then, in the late 1980s, by accumulating foreign debt.

The pattern of change in Finnish export competitiveness as a whole is similar to that in the Soviet market. Overall, Finland increased its share of world markets in 1970-1986, but performed best in commodity markets that grew at a slower than

[20] For a discussion on the later destinies of Soviet exports of the Finnish shipbuilding and textile industries, see Sutela (1991a).

average pace. As Hukkinen (1990) shows the structure of Finnish exports to the Soviet Union changed faster than the overall structure of Finnish exports, and therefore it would seem difficult to substantiate the claim often voiced in Finland and elsewhere that in general Finland's trade with the USSR has retarded necessary structural changes in the economy because of the survival effect mentioned above. On the other hand, one should recall that Soviet import demand changed faster in 1970-1986 than world import demand. As a result, Finnish exporters did not keep up with changes in Soviet demand as well as they did with respect to the slower-changing world demand. To put the point more bluntly, relative to change in demand Finnish exporters fared in the East even worse than in the West.

It would seem plausible to argue that this is not independent of the way in which trade has been conducted. The decades-long traditions of trading, the relatively small numbers of firms involved and the highly structured institutional framework on the Finnish side may all have had an influence. But this is only one side of the coin. As emphasized above, the performance of Finnish export industries in the Soviet market should be viewed in the context of their overall export performance. Fortunately, none of Finland's industries actually specialized completely in exporting to the USSR. However, certain enterprises and corporative units did just that, and it appears that their relative importance increased in the 1980s (Kajaste - Mattila, 1988).

From the very beginning, Finnish policy aimed at avoiding the complete dependence of any sectors on sales to the USSR. Even the largest Finnish conglomerates – private or state-owned – have usually sold only some 10-15 percent of their output to the USSR. The general policy of avoiding sectoral dependency continued until the early 1980s, when the sudden increase in Soviet demand seems to have overwhelmed at least two Finnish manufacturing sectors, shipbuilding and certain branches of light industry, foorwear in particular. Over the period 1982-1985, some 60-80 percent of Finnish ships were sold to the USSR, while in footwear the share was around 40-50 percent. Five years later, the sales of these sectors to the USSR had collapsed (see Table 1), as had many of the companies involved.[21]

[21] Foreign trade statistics for 1985 reveal (on the 7-digit level of CCCN-classification) 133 items for which the share of Soviet exports was over 90 percent of all exports. These items add up to 38 percent of total exports to the USSR. Fifteen of them are important, each accounting for more than FIM 100 mill. in exports. Five of the important items are different kinds of ships and the rest are products of the food, chemical, paper, clothing and electro-technical industries. Of the total exports of these 15 items, 96 percent went to the USSR in 1985. In 1985-1991 the exports of these items dropped by 83 percent, which is even more than the overall drop in Finnish exports to the Soviet Union. For these commodities, the collapse of the Eastern market was only to a very limited extent - six percent - compensated by exports to the West (Kajaste, 1992).

Table 1. **Exports to the USSR, mill.FIM**

| | 1990 | 1991 | 1991 in % against 1990 |
|---|---|---|---|
| Total export | 12888.1 | 4522.4 | -64.9 |
| 0 Food and live animals | 793.9 | 314.1 | -60.4 |
| 1 Beverages and tobacco | 9.0 | 12.0 | 33.5 |
| 2 Crude materials, inedible, except fuels | 395.6 | 86.8 | -78.1 |
| 3 Mineral fuels etc | 72.0 | 82.2 | 14.2 |
| 4 Animal and vegetable oils and fats | 0.1 | 0.3 | .. |
| 5 Chemicals and related products, n.e.s. | 978.6 | 645.1 | -34.1 |
| 6 Basic manufactures | 2959.8 | 733.0 | -75.2 |
| 7 Machinery, transport equipment | 5820.8 | 1755.9 | -69.8 |
| 8 Miscellaneous manufactured articles | 1858.4 | 893.0 | -52.0 |
| 9 Goods not classified elsewhere | - | 0.0 | .. |

**Imports from the USSR, mill.FIM**

| | 1990 | 1991 | 1991 in % against 1990 |
|---|---|---|---|
| Total import | 10196.3 | 7460.9 | -26.8 |
| 0 Food and live animals | 17.9 | 24.4 | 36.5 |
| 1 Beverages and tobacco | 1.0 | 0.6 | -39.0 |
| 2 Crude materials, inedible, except fuels | 985.4 | 814.6 | -17.3 |
| 3 Mineral fuels etc | 7059.1 | 5372.5 | -23.9 |
| 4 Animal and vegetable oils and fats | - | - | - |
| 5 Chemicals and related products, n.e.s. | 361.9 | 355.6 | -1.7 |
| 6 Basic manufactures | 479.9 | 377.2 | -21.4 |
| 7 Machinery, transport equipment | 809.8 | 403.1 | -50.2 |
| 8 Miscellaneous manufactured articles | 481.4 | 112.9 | -76.5 |
| 9 Goods not classified elsewhere | 0 | - | .. |

Source: Board of Customs

## 7 The demise of clearing in Finnish-Soviet trade

After the USSR had announced its intention to abolish the existing trade regime in its foreign trade with the CMEA-area, a similar announcement in the summer 1990 concerning clearing trade with Finland should have been no surprise. Many Finnish export industries, however, campaigned for a continuation of clearing or at least for a transitional period of two or three years. They were encouraged by the fact that signals coming out of Moscow were somewhat contradictory.

The analysis of Finnish discussions in 1990 on the future of clearing trade with the USSR will prove an interesting topic for future historians. Here we can only outline the arguments raised in the debate.

The views of the supporters of clearing – mainly the spokesmen of established export industries – can be summarised very easily. Without ever being explicit about how and why, they argued that as clearing had been advantageous to the Finnish economy, it should be continued. If not, there should at least be a transitional period of two or three years to allow time for adjustment.

As the pro-clearing view was argued from positions of power, its antithesis had to be developed at greater length. At least six arguments were used.[22] **First**, there was no longer a functioning planning and allocation mechanism for foreign trade in the USSR. By clinging to the tail of the earlier mechanism Finland faced the danger of being seen as a supporter of the ancient regime in the USSR. **Second**, the USSR is obviously depoliticizing its foreign trade. There is no reason why bilateral clearing trade with Finland would fulfil the economic trade criteria now crucial in decisionmaking. **Third**, indeed, there are good reasons to argue that clearing with Finland is economically disadvantageous to the USSR. **Fourth**, continuing clearing trade with Finland would have been an anomaly in the overall conduct of Soviet foreign trade. **Fifth**, bilateral clearing does not go well with the general thrust of Soviet economic reform attempts. **Sixth**, clearing does not go well with the spatial devolution (or dissolution) of the USSR.

These are admittedly rather self-evident points, and the need to emphasise them in 1990 illustrate the degree to which the perceived short-term interests of the established export industries determined the policies not only of industrialists' associations but also those of the state.[23]

[22] Though the relevant discussion was rather wide-ranging, these points were probably presented for the first time publicly and comprehensively only ex post facto in Sutela (1991b).

[23] Need it be said, after the above characterization of Finnish corporatism, that the state foreign economic policy apparatus did indeed seek to establish a transitional arrangement?

# 8 The macroeconomic implications of the collapse of Soviet trade

Calculations using both the Bank of Finland's BOF4 quarterly model of the Finnish economy and the KESSU model of the Finnish Ministry of Finance show that the collapse of Finnish exports to the USSR contributed some 2-3 percentage points to the total decline of Finnish GNP in 1991 (Rautava – Hukkinen, 1992; Valtiovarainministeriö, 1992). As the overall decline was 6.2 percent, the collapse of exports to the USSR would seem to be an important, but not the major cause of the deep Finnish economic crisis. The main reason, by general consensus, was the excessive Finnish cost level attained over a decade of higher than OECD-average economic growth, financial deregulation and overfull employment.[24] Also, a deep recession in such important export countries as Britain and Sweden as well as the global oversupply of forestry products contributed to the Finnish crisis.

Though estimates here are very uncertain, it seems that perhaps 30000 - 40000 of the total 150000 increase in the number of unemployed in 1991 can be attributed to the collapse of export to the USSR.

There is, however another way of looking at the matter. As outlined above, the traditional system of trading with the USSR contributed to and was an integral part of the Finnish corporatist system of governance. There is a widely shared view that though corporatism may have served Finland well in the past, as a whole it has outlived its workability (see, for instance, OECD, 1991; Pekkarinen et al., 1992). According to this view, which is also heard often in current economic policy debates in Finland, the country now has to undergo a readjustment towards competition, flexibility and an opening up of the same kind that many European countries have seen during the 1980s.

In this perspective, views to the effect that the current Finnish economic crisis is fundamentally a reflection of the Soviet collapse (Pihkala, 1991) are not totally without basis, though they surely remain exaggerated.

[24] For a more extensive but perhaps overly optimistic discussion see OECD (1991).

# 9 Perspectives for the future

In future, Finnish exporters can continue to count on the factors of geographical proximity, traditions and knowhow in trade with Russia. On the other hand, they will be constrained by Finland's overall level of competitiveness and financing possibilities. On both accounts, Finland is not well positioned for the 1990s. Neither is there any reason to believe in a fast growth of Soviet import demand. It can also be expected that Russian business circles will have a natural preference for those potential partners that can offer the prestige of giant companies, well-known trade marks and hospitable destinations for business trips. Finnish entrepreneurs hardly have a relative advantage here, and may well have to look for niches as well as strategic partners.

Overall, surveys show that established Finnish exporters to the USSR intend to stay in the Russian market. They see their strength in experience and knowledge of markets, whereas competitiveness and financing possibilities are cited as the major Finnish handicaps (Rantanen, 1992).

Since 1990, Finnish authorities have been unwilling to increase the amount of finance and guarantees offered on Finnish exports to the USSR and Russia. Total **Soviet debt to Finland** is some FIM 5.5 billion (approx. ECU 1.1 billion). This total has not changed in 1991. It is about two percent of total Soviet foreign debt, but on a per capita basis it is, following Austria, the second highest in the world.[25] Payment arrears are estimated to be about 10 percent of this total.

The problem is not only in the total amount of Soviet debt to Finland. It is rather a question of the total foreign debt of Finland, which has been rising very fast. If money raised abroad were used to finance Finnish exports to Russia, increasing foreign debt would be open to the upward pressure of markets rightly suspicious of the ability of Russia and the other states of the CIS to fulfil their obligations. A further problem is caused by the fact that most credits extended to the USSR have been guaranteed by the state-owned Finnish Guarantee Board. On commercial grounds, the Board has not been willing to further increase its exposure to the USSR and Russia. Increasing the Russian limit would require a decision by Parliament, and there has not been the political willingness to do so.[26]

Though the clearing account could be liquidated in almost perfect balance, some remnants of the clearing system still remain. Thus, in Spring 1991 Finland offered the USSR a fresh credit line of FIM 1.5 billion for financing projects that had been started under the clearing system but had been subsequently interrupted. Because the USSR was not willing to comply with the condition attached, the creditline has remained unused. There is also a so-called special account, an interest-bearing balance separate from the clearing account proper, with a Russian liability of SUR

[25] Though in principle totally irrelevant other than as a proxy for national income levels, this has been a favoured basis for comparison in Finland.

[26] In fact, even though Finnish companies were early reported (see **Uusi Suomi** 22 August 1991) to have contracts worth FIM 7 bn waiting for finance, even the present Export Guarantee Board limit has not been exhausted fully, which reflects the unwillingness of enterprises to carry the 30 percent residual risk involved.

60 million, which was to be liquidated at the end of 1991. However, due to well-known Russian problems, this could not be done.

In the shadow of the collapse of traditional trade, developments have been underway in nontraditional fields. Until the end of 1990, the establishment of Finnish-Soviet **joint ventures** in principle required the permission of the Bank of Finland. As a result the Bank has fairly comprehensive information on such ventures. A survey of existing Finnish-Soviet joint ventures, made in spring 1991, revealed some rather interesting details (Laurila, 1992). In particular, a sizable portion of Finnish joint venture partners were reasonably satisfied and optimistic about their business activities in the USSR. Though Finnish-Soviet joint ventures are numerous – Finland occupies third place, after the USA and Germany, in the numbers of Soviet joint ventures – almost all of them are small. Such relative satisfaction must therefore be seen against modest original goals and risks. Overall, Finnish investors have been cautious and therefore disappointments have seldom been catastrofic. This should perhaps be taken as a sign of understanding accumulated over decades of trading with the Russians.

The possibilities for **direct investment/technical assistance** would merit a lengthy discussion. Though without going through this extensive area here, one example has to be addressed. It concerns the Nikel and Montsegorsk smelting works on the Kola Peninsula. This example is interesting in its own right, but it also illuminates some of the more general features of the Russian economic environment.

The sulphuric emissions in the Kola Peninsula are about four times higher than those of Finland as a whole. It has been calculated that in 1987 almost 20 percent of all sulphuric depositions in Finland originated from neighbouring Soviet areas. In eastern Lapland, the share reaches 80 percent. Furthermore, other calculations imply that the marginal cost of diminishing sulphuric emissions is about five times as great in Finland as in neighbouring Soviet plants. Indeed, it has been argued in a game theoretic context that this is a case where the victim should bribe the emitting partner to abate pollution (Kaitala et al., 1991).

All the estimates concerned are highly uncertain, and the purely economic value of the marginal forests of Lapland is low. Still, perhaps due to the symbolic worth of some of the last remaining wildernesses of Europe, the governments of Finland, Norway and also Sweden have for some time already exerted pressure on the USSR to take measures to modernize the outdated smelteries of Nikel (just on the Norwegian border) and Montsegorsk (towards the inland of the Kola Peninsula). For this purpose, both Finnish technologies and Nordic money has been offered. Still, the project has in many years not advanced to the point where actual commercial negotiations could have commenced.

The reasons for this are enlightening also from a more general perspective, as same problems may well be met with in other projects of assistance as well. **First**, Moscow had to be convinced of the importance of the matter. Though Kola smelteries may top the list of Finnish and Norwegian ecological emergencies, they reportedly used to occupy roughly the 50th place on the Moscow priority list. Many Soviet decisionmakers still regard the taking of measures in Kola as something of a concession to the Scandinavians, and may even expect counter services. Many local decisionmakers also long refused to admit that they might have a problem.

**Second**, as surprisingly backward-looking as it may sound, many Soviet authorities have still refused to believe that foreign technologies might be better than theirs. They have proposed a Soviet process which is not only less efficient but also literally does not exist for the time being. Norwegian environment authorities have at times seemed ready to accept the Soviet alternative.

**Third**, the Soviet authorities have been unable to earmark the resources which would be needed to complement the foreign resource inflow. This has already led to a crucial curtailment of the whole project so that it is now planned to only include the Nikel smeltery.[27]

**Fourth**, there was for a long time uncertainty as to the owner of the smelteries. It now seems that while decisions may fall under the competence of the Norilsk Nikel Combine and Kola authorities, financing still has to come from Moscow.

**Fifth**, the Finnish side has promoted the project since about 1985, on the highest political level since 1989. While the prospective main contractor finalized its commercial offer by the end of October 1991, the Scandinavian authorities found themselves in a position of having no counterpart. All-Union authorities were abolished and no Russian partner was found for a long time.

[27] Nikel is important for Norway, while Montsegorsk is the real problem for Finland.

## 10 A model for the countries of the CIS?

Clearing, both bilateral and especially multilateral,[28] has been proposed as a trading regime both for the countries of Eastern Europe after the collapse of the CMEA and especially for the countries of the CIS. What can the Finnish experience of trading with the USSR contribute to such considerations? Though the Finnish experience comes from bilateral trading, while the implied preferred solution for Eastern Europe and the CIS seems to be multilateral clearing, the following remarks would seem pertinent.

Clearing, as opposed to enterprise level barter or counter purchasing, is based on government-level framework protocols and administered by government bodies. The Finnish experience shows that this does not necessarily imply that enterprises would simply become the executers of political decisions. On the contrary, the normal flow of decisions ran from enterprise-level negotiations through industrial associations to bureaucrats and politicians, who in most cases simply ratified what had been negotiated by enterprises. Still, this is a corporatist procedure and there is certainly no guarantee against a more activist political attitude. Furthermore, as soon as trade balances become a problem (as they surely would among the countries of the CIS), it necessitates formal licensing procedures or specific financing facilities. Altogether, this readily implies a high degree of state involvement in trade, something that economies in transition might want to avoid as a matter of general policy guideline. Anyway, such government involvement is bound to create problems of transparency, rent-seeking, incentives and bureaucratic capabilities.

Traditional industries with well-established interests would inevitably be in a better position to acquire quotas and licenses than is possible for emerging small industries. As also seen in the Finnish case, clearing arrangements would therefore have conservative structural implications.

Strict clearing with no credit facilities would inevitably be seen as being too inelastic. The introduction of credit lines, on the other hand, easily creates a situation where one partner of the trading arrangement becomes more or less a permanent net financier of exports. This is nominally done to maintain trade levels, but in reality it should in many cases be seen as a form of domestic industrial subsidies.

The situation would be further complicated if the currency earning capacities of the trading partners are unevenly distributed. In the case of the CIS, for instance, Russia's export potential is much greater than that of the other economies. The Federation, being an exporter of such hard goods as energy and raw materials, does not have any economic reason to engage in clearing arrangements. Selling in exchange of Belarus engineering goods is hardly more advantageous than selling for convertible currencies. Russia would therefore accept clearing arrangements only for political reasons or in exchange of advantages in pricing, finance or other trade conditions. That would add to the nontransparency and political character of the trading arrangement.

[28] The difference between these two arrangements is not necessarily huge. Experience with the CMEA illuminates how clearing meant to be multilateral all too easily develops into bilateral clearing. See Csaba (1990).

It is naturally widely admitted that clearing arrangements, being essentially a form of discrimination against third partners, are essentially an impediment to free trade. They are defended on grounds of maintaining trade levels, production and employment. Whatever the value of such arguments as such, it should be noted that empirical evidence shows that the trade levels have already to a large degree collapsed without there being conclusive evidence that trade losses would have been the major cause of rapidly declining production in Eastern Europe (ECE, 1991). In these matters, as so often in general, the owl of Minerva truly flies only in the dusk.

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