

Trade with Russia and its importance for Finnish companies

28 October 2008

Finland's trade with Russia has grown rapidly in recent years, and since the turn of the millennium Russia has once again become one of our largest trading partners. Russia is an important export market for Finland, particularly for those companies and industries whose operations are otherwise largely focused on the domestic market. The present significance of exports to Russia is, however, considerably less than during the Soviet era. Imports from Russia are concentrated on just a few companies and industries, although for them Russia represents an important source of raw materials. This article examines recent developments in trade between Finland and Russia, its special features and the significance of this trade for Finnish companies. Some attention is also given to the corporate structure of trade with Russia.

In the past, Finland's trade with Russia has been markedly different from our other foreign trade, initially because of the Soviet Union's planned economy, and later due to the unusual operating environment caused by the transitional phase in the Russian economy. Trade with Russia still has its own distinctive features relative to other foreign trade, despite the considerably more stable and open Russian economy of the present day.

These distinctive features are largely reflections of two factors: on one hand the nature of the Russian economy, which is still largely based on output of raw materials, and on the other hand Finland's geographical location between Russia and the markets of western Europe.

The Russian economy is still highly dependent on earnings from the energy sector, although this is not the real engine of growth in the economy. Over the course of the present decade, the Russian economy has grown at an average rate of 7% per annum. Growth has been driven particularly by domestic demand, supported by the strong rise in oil prices. The high level of oil revenues has, however, meant many other production sectors have been somewhat neglected, and domestic output has been unable to meet the growing demand. This has led to a strong increase in Russian imports in recent years, at an average rate of around 20% per annum in real terms. Import growth has been supported by the steady appreciation in the value of the rouble. The concentrated nature of Russian production has meant exports are made up almost entirely of energy products and other commodities, while the country has few other products of interest to international markets.

For Finland, this has meant that imports from Russia also consist mainly of energy products and raw materials for domestic consumption



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and processing for higher value-added export goods. Russia's rapidly growing imports, meanwhile, have provided Finnish companies with a large export market close to hand, and they have taken advantage of this opportunity.

Its close proximity and weaker competition in many sectors as recently as the early years of the present decade have also made Russia an important market for smaller companies and for companies operating in industries outside of Finland's traditional export sectors. Products that otherwise play a major role in Finnish exports, such as paper and metals, are less important in exports to Russia, which has more output of its own in these sectors. Finland's very favourable location close to Russia has helped the emergence of this export trend that differs from the mainstream of Finnish exports. However, Finland does not produce many of the products that are in great demand in Russia, particularly consumer goods. This demand has been met by importing goods from elsewhere and re-exporting them to Russia, or simply by Finland serving as a route for the passage of transit goods to the Russian market.

Re-exporting clouds the picture of export trends

The value of Finnish exports to Russia has grown by an average of around 20% per annum during the

present decade, and Russia's share of Finnish exports has risen to a good 10%. In 2007, the value of exports to Russia totalled EUR 6.7 billion. The largest product group is machinery, equipment and vehicles, which together accounted for over half of all exports to Russia in 2007. Over the course of the decade, cars and mobile phones have become the most important individual export items. Chemical industry products are also important, with their share of exports to Russia fairly constant at around 15%. In contrast, the share of exports to Russia taken by product groups that are important in other export markets, such as paper and metals, is much smaller and has contracted further in recent years. Russia has more output of its own in these product groups. In addition, food products' share of exports to Russia has declined by approximately a half, to around 4%, during the present decade.

In recent years, however, the pace of growth in Finnish exports to Russia has slowed considerably, despite continued strong growth in Russia's total imports. In 2006 and 2007, the value of exports grew by just 8%, while Russia's total imports continued to grow strongly, by almost 30% in terms of their value in euro (Chart 1). This trend is partly explained by changes in the exports of two important individual products. Mobile phone exports to Russia declined considerably in 2006, followed the following year by a

marked deceleration in the pace of growth in car exports, which had been growing very quickly in previous years. It was the strong increase in exports of these two products that had been responsible for a considerable proportion of total export growth to Russia in previous years. The accelerating pace of export growth in the first half of 2008, meanwhile, is largely due to a renewed vigorous increase in car exports.

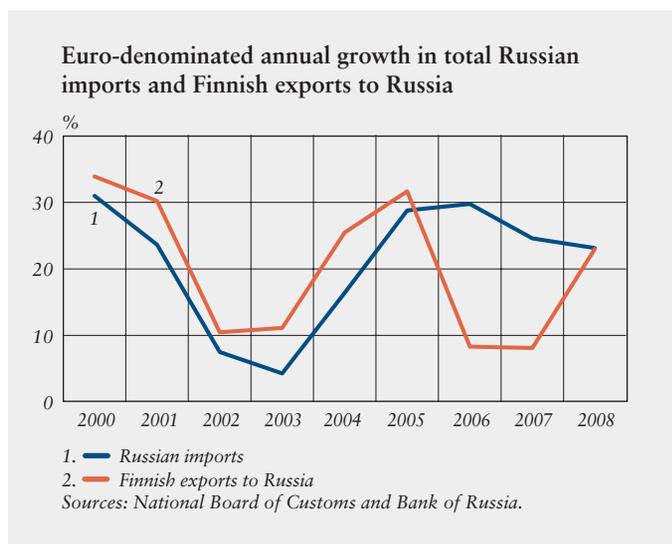
Some of these mobile phones, and, in practice, all the cars, are re-exports that simply pass through Finland en route to Russia. These products are not manufactured in Finland, being simply brought into Finland from third countries as normal imports and then sent on (re-exported) to Russia. Products for re-export are imported to Finland as end products, and are therefore not further processed in Finland, but they may be re-packed or equipped with Russian-language manuals before export to Russia. Re-exports are estimated to account for 25–30% of Finland's exports to Russia.¹ Other important re-export products, in addition to cars and mobile phones, are home appliances and electronic equipment as well as some chemical products, such as medicines.

It is worth distinguishing re-exporting from transit traffic,

¹ National Board of Customs (2008), Jälleenvienti Venäjälle vuonna 2006 ('Re-exports to Russia in 2006'); Ollus & Simola (2007), Finnish re-exports to Russia, BOFIT Online 5/2007.

despite their undoubted similarities. Re-export goods are brought into Finland, primarily via a Finnish intermediary, and enter the country as normal imports that can be freely sold within Finland. In contrast, the destination, route and timetable for transit traffic is determined in advance at the point of origin, and transit goods can only be stored in designated storage facilities. Moreover, transit traffic is not included in Finland's foreign trade statistics, being recorded in separate statistics compiled by the National Board of Customs. Transit goods comprise largely the same products as re-export goods, particularly cars, but their volume is many times greater than the volume of goods for re-export.

Chart 1.



Re-exporting is still rather a new phenomenon, and one related largely to Finnish exports to Russia.

Russia is undoubtedly a significant export market for the trade sector, as almost one third of all exports by companies in the sector go to Russia.

Trade sector companies more prominent than others in exports to Russia

Re-exporting is still rather a new phenomenon, and one related largely to Finnish exports to Russia. Both re-exporting and transit traffic are largely based on the location of the Finnish market between Russia and the rest of the EU. Re-exporting is pursued mainly by large companies in the trade sector. Because Russia has a lot of demand for goods that are not produced in Finland, Finnish trading companies supply the Russian market with goods produced elsewhere. Admittedly, some of the goods exported by Finnish trading companies are also produced in Finland. Re-exporting, in particular, is also partly explained by companies expanding their operations into Russia. It is often easier for these companies to import goods in bulk to Finland and then redistribute to Russia the goods needed in the Russian market.

Re-exporting is also clearly reflected in the corporate structure of exports to Russia. Companies in the trade sector enjoy a one third share of exports to Russia, compared with just a 10% share of total Finnish exports. As the goods are merely delivered via Finland, not produced here, the income and, particularly, employment effects of re-exporting are less than with traditional exports. Admittedly, trade sector companies do benefit from these exports, as they receive

income from their role as intermediaries. The other main beneficiaries from re-exporting are providers of storage and haulage services.

Russia is undoubtedly a significant export market for the trade sector, as almost one third of all exports by companies in the sector go to Russia. Even so, the overall significance of exports to companies in this sector is rather small. Meanwhile, companies whose operations are based primarily on re-exporting could find it hard to sustain their competitive advantage in the future. In contrast to transit traffic, in re-exporting, the Finnish-based supplier must be able to retain its intermediary role so as to ensure the goods are not sent straight to the purchaser in Russia. The future of re-exporting could also be affected by a variety of extrinsic factors, with the potential for rapid changes that could be on a significant scale, such as has already happened with mobile phones. Such rapid changes could at the same time obscure the overall trend in Finnish exports to Russia.

Russia as an extension of the domestic market

Most Finnish exports to Russia do, however, involve the traditional exporting of goods produced in Finland. The value of this trade has grown in recent years by a good 10% per annum. Because Finnish exports to Russia have, however, grown more slowly than overall import growth in

Russia itself, Finland's share of the Russian market has declined in recent years by a couple of percentage points. This trend has a number of causes. The Russian market has become more competitive, with China in particular increasing its market share, as it has in world trade overall. Finland is a small economy, and a lack of production capacity is one factor that has restricted growth in exports to Russia. Relative to the size of the economy, Finland nevertheless remains one of the EU's largest exporters to Russia. In some sectors, growth in these exports has also been slowed by Finnish companies replacing their exports with local production in Russia.

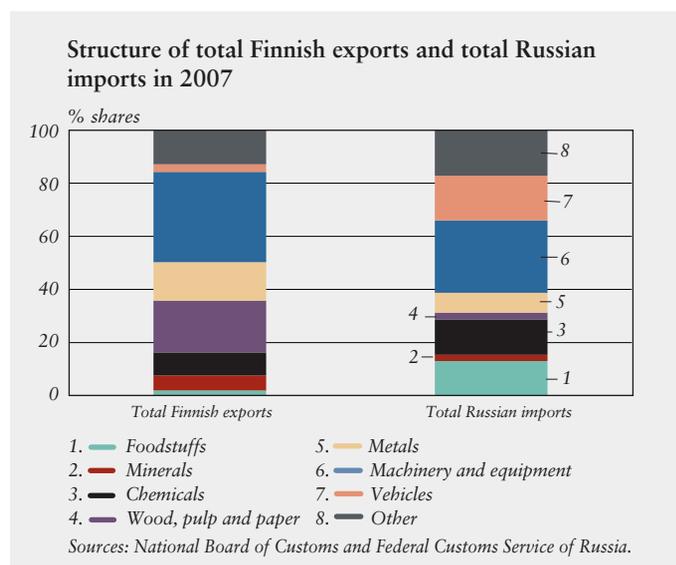
Also relevant is that the structure of Russian import demand differs from that of Finland's export supply. The most important exports from Finland to Russia are machinery and equipment, and chemical industry products. Demand for these has been stimulated, particularly in recent years, by the rapid growth of investment in the Russian economy. The greatest single factor in Russian demand is, however, demand for consumer goods, which are not produced in any great quantities in Finland. This difference between the structure of Russian imports and Finnish exports is one of the reasons Finnish exports to Russia have not grown as quickly in recent years as Russian imports overall (Chart 2).

The majority of exports to Russia (excl. re-exports) are from companies that produce machinery, electronic equipment and chemical products. The share of these industries' total exports that go to Russia is well below 10%. Taken as a whole, the least significant sectors in the export trade with Russia are Finland's traditionally important export sectors like the forest and metal industries. All these industries export a lot of goods to other markets, thereby reducing the importance of any single market. Moreover, there is less demand for forest or metal industry products in Russia due to the level of domestic output in these industries.

In contrast, exporting to Russia is most important for those industries whose main focus is on the home market, such as the textile and food

In contrast to the Soviet era, no Finnish industry today is strongly dependent on exports to Russia.

Chart 2.



Finland's foreign trade is pursued by a relatively small proportion of all Finnish companies, with most of it in the hands of only a few companies.

industries as well as manufacturers of non-metal mineral products (eg building materials). In these sectors, Russia's share of exports has in recent years been in the range of 10–25%. The importance of Russian exports to these industries is partly due to the proximity of the Russian market, as a large proportion of their exports go to nearby trading partners, including eg Sweden. There is also an historical background to the relative prominence of Russia as an export market for these sectors, as many of their products played a relatively prominent role in exports to the Soviet Union. However, no sector of Finnish industry is significantly dependent on the Russian market, as many were during the Soviet era. Exports to Russia account for only a few percentage points of total turnover in all sectors.

Russia is an important export market for SMEs

As foreign trade is carried out by individual companies, an analysis at company level can yield interesting additional information. International studies have shown that foreign trade, and particularly exports, is generally pursued by just a small proportion of companies, with the vast majority focusing exclusively on the home market. Foreign trade has also often been characterised as concentrated, as most of it is in the hands of just a few of the largest companies. Moreover, many

companies engage in trade with just one or a few countries and focus their foreign trade on just one or two products.

Many of the above features also apply to Finland's foreign trade. A relatively small proportion of companies engage in foreign trade, most of which is in the hands of only a few companies. The corporate structure of trade with Russia does, however, differ somewhat from the rest of Finland's foreign trade. The analysis of corporate structure presented here draws on the comprehensive and detailed information on Finnish companies trading with Russia contained in the VIRKE databank.²

In 2006 around 4,000 Finnish companies exported to Russia. Of these companies, a good 600 were large, and the rest were SMEs.³ Measured by the value of exports, SMEs still accounted for almost a fifth of total exports to Russia in 2006, while their share of other exports has remained at a good 10% in recent years. The value of SME

² VIRKE is a Finnish government project for inter-authority cooperation in combating economic crime. It has provided us with a database for research purposes that contains data gathered by the National Board of Customs and the tax administration on all Finnish companies engaging in trade with Russia. The database covers the years 2002–2006. Statistics on the corporate structure of Finland's foreign trade are also provided in the National Board of Customs publications *Tavaroiden ulkomaankauppa yritysten kokoluokittain* ('Foreign trade of goods by enterprise size') and *Tavaroiden ulkomaankaupan keskittyminen yrityksittäin* ('Concentration of foreign trade of goods by enterprise').

³ The classification of SME is applied to all companies employing less than 250 employees or with a turnover of less than EUR 50 million.

exports to Russia grew by a third in total over the years 2002–2006, while the value of exports by large companies doubled over the same period. SMEs' share of exports to Russia has thus declined in recent years, while the number of SMEs involved in this trade has also dropped.

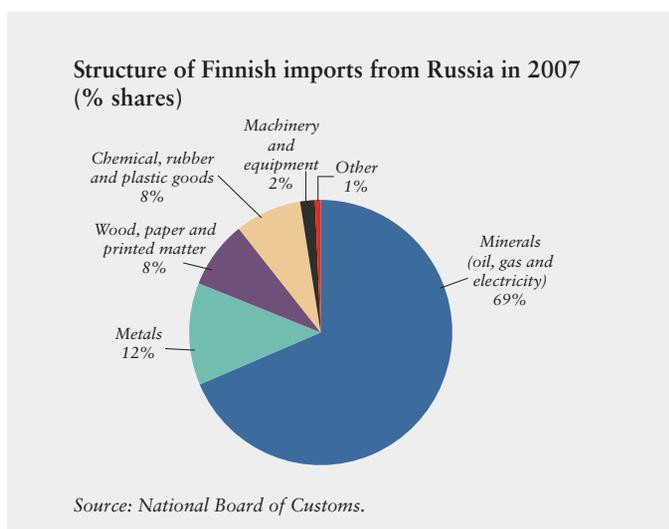
As an export market, Russia is, however, of particular importance to Finnish SMEs, who sent almost 15% of their exports to Russia in 2006. Large companies, meanwhile, sent less than one tenth of their exports to Russia. Large companies generally export to more markets and are also often better equipped to expand operations abroad, which means the significance of an individual export market is not so great.

SMEs, in contrast, often find it easier to focus their exports on nearby markets. The share of SMEs is greatest in the exports to Russia from eastern and southeastern regions of Finland, ie close to the Russian border. Admittedly, Russia is not the easiest of export markets, but, in addition to its proximity to Finland, the rapid growth in demand and relative lack of competition that still exists in many sectors have helped make the Russian market more attractive to SMEs. Only a small proportion of Finnish SMEs are direct exporters, and for the SME sector as a whole the significance of exports to Russia is in this sense rather limited. However, considerably

more SMEs are involved in exports through subcontracting, which boosts the importance to the SME sector of exports in general, including exports to Russia.

The Finnish companies that export to Russia are fairly specialised for the Russian market, and this is a feature that has increased further in recent years. In 2006, more than half of all companies exporting to Russia exported only to Russia. Russia's average share of total exports by Finnish companies exporting to Russia grew in the years 2002–2006 from around 60% to over two thirds. Despite the fact that in value terms the greater part of SME exports to Russia come from the Uusimaa area along the south coast, where the greatest concentration of companies is also located, the SMEs that are most strongly specialised in exporting to Russia are located in the southeast

Chart 3.



of the country, the area of Oulu and Kainuu in the north and along the Russian border in the east.

Exports to Russia accounted for an average 10% of the turnover of companies participating in this trade in 2006,⁴ a slightly higher figure than in 2002. For a small proportion of companies, however, exports to Russia are vital, as they account for over half of their total turnover. SMEs are particularly dependent on this business, while for large companies only a few derive even over a quarter of their turnover from exports to Russia.

Imports from Russia are very concentrated

The value of Finland's imports from Russia has grown during the present decade by an average of around 20% per annum, reaching EUR 7.8 billion in 2007. This trend largely reflects the rising prices of oil and other commodities. Traditionally, imports from Russia have consisted of energy products and raw materials. The former (oil, oil products, gas and electricity) at present comprise almost 70% of Finnish imports from Russia (Chart 3). Other important imported goods include metals, roundwood and chemical products, which have each accounted for around 10% of imports from Russia in recent years.

Almost a fifth of imports by large companies and industrial manufacturers come from Russia.

⁴ In order to ensure the comparability of turnover and export data the examination has been restricted to companies whose financial statements are based on the calendar year. It therefore covers only just over a half of all potential companies.

In contrast, more refined or processed goods, such as machinery and equipment, are relatively insignificant in imports from Russia, accounting for only one or two per cent of the total.

In 2006, there were approximately 1,400 companies in Finland engaged in importing from Russia, of which a good 300 were large. Measured by value, SMEs' share of imports from Russia has remained steady at around 5%, considerably less than in imports from other countries, where SMEs account for almost a quarter of the total. The concentration of imports from Russia is largely a reflection of the predominance of oil and other commodities, which are imported mainly by just a few large corporations.

Russia is a much more important source of imports for large companies and industrial manufacturers in Finland. Both these categories purchase almost a fifth of their imports from Russia. In some industries, as for example in the manufacture of oil products and in the forest industry, Russia's share of imports is much larger still, due to the unbalanced structure of imports. In contrast, companies in the trade sector derive less than one tenth of their imports from Russia, while only one or two per cent of imports by SMEs come from Russia. Of these SME imports, the largest share is by trade sector companies. For SMEs in manufacturing, the most active

importers from Russia are those that operate in the forest and chemical industries. In addition, most food industry imports from Russia are imported by SMEs, although the food industry's share of total imports is admittedly very small.

Of all companies involved in importing from Russia, just under a half import only from Russia. The importance of imports is greatest for a few major commodities importers, but many SMEs in eastern and northern Finland also import almost exclusively from Russia. While Russia's average share of all the imports by companies that import from Russia is a good 60%, the average for SMEs in eastern and northern areas is 90%. Among SMEs and companies in the north and east of the country, the structure of imports from Russia is also considerably more diversified than for the country as a whole; even so, it still comprises mainly relatively unprocessed goods.

Russia's significance as a trading partner is important, but limited

Trade between Finland and Russia is still based largely on comparative advantage and mutually complementary trading structures. Finland primarily imports raw materials from Russia and exports manufactured goods. In contrast to Finland's other foreign trade, there is very little intra-industry trade. The rapid growth of demand in Russia has, however, been

particularly marked in consumer goods, which Finland does not produce in any significant quantities. This demand has therefore been met by importing consumer goods from third countries and re-exporting them to Russia.

Although 2008 has seen the restoration of Russia's position as Finland's largest single export market, the large share of re-exporting reduces the significance of this to some extent. The impact of re-exporting on national income, and particularly on employment, is much less than with traditional exports, because the products involved are not made in Finland.

In Finland's largest export industries, the Russian market accounts for well under a tenth of exports. In these industries, both exports and production are often distributed across a number of markets, making them less dependent on any single export market. The rapid increase in import demand in Russia has, however, compensated companies in these industries for the more sluggish state of many other markets in recent years.

Relatively speaking, Russia is most important as an export market for those industries and companies in which exports play only a marginal role. For industries that focus primarily on the domestic market, Russia has served as an extension to this core market, and a large proportion of exports go to Russia as

well as to other nearby markets. There is, however, no industry in Finland that is highly dependent on the Russian market, like in the days of the Soviet trade.

For SMEs, too, Russia is fairly important as an export market, and many SMEs export only to Russia. However, only a very small proportion of SMEs engage in any export activity; therefore, for the sector as a whole, the importance is marginal. On the other hand, a considerably larger number of SMEs participate in exports to Russia indirectly, as subcontractors.

Imports from Russia still consist mainly of energy products and other commodities, and import trends have been largely determined by the rising prices for these products. Imports from Russia are concentrated in just a few industries, and Russia's share of imports in these industries is considerable. In terms of corporate structure, too, imports from Russia are dominated by a relatively small number of large industrial corporations, for whom they are very important.

Thus, Finland's trade with Russia still differs somewhat from trade with other countries. For exports, in particular, one factor driving this difference is the location and proximity of the Russian market, which make it a very important export focus for those Finnish companies that have less opportunity in other export markets.

The differences in imports from Russia are largely due to the different product structure, with the strong focus on oil and other commodities.

Keywords: foreign trade, companies, Finland, Russia