BANK OF FINLAND BULLETIN

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A brief history of Finnish foreign trade

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Finland is a small open economy, where fluctuations in exports and imports have shaped the big picture of developments in the economy. A historical review of these developments suggests that the current situation provides no such conditions for rapid export growth supporting the economy as those seen in the earlier growth phases of economic history. Despite facing difficulties, the forest industry is still one of the pillars of Finnish exports alongside the machinery and metal industry.

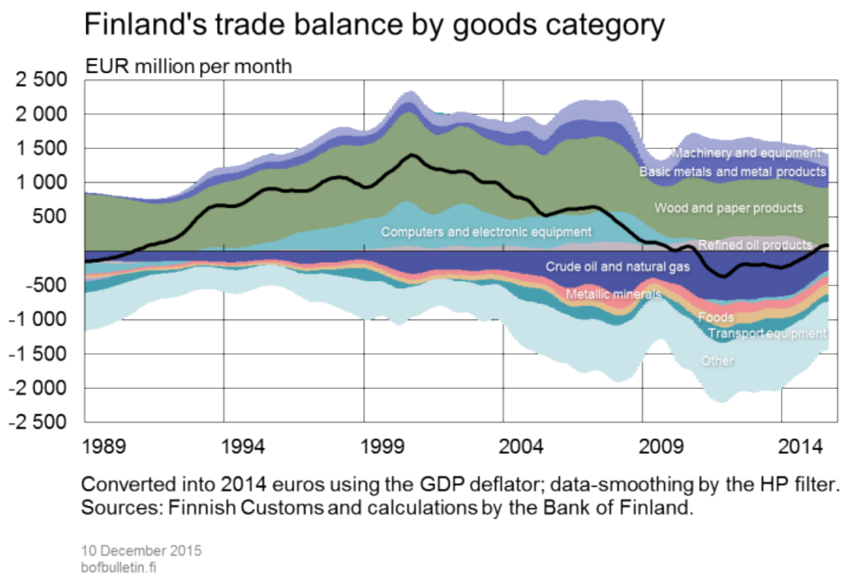
Future of foreign trade from a historical perspective

In recent years, the structures of the Finnish economy have undergone radical changes in the wake of difficulties encountered by the forest and electronics industries, and these transformations are also reflected in the composition of foreign trade. Export earnings from the mobile phone business, which had long underpinned our economy, have disappeared, the significance of Russia has diminished and commodity prices have plummeted. Export recovery has been expected to bring a solution to the already protracted weak economic situation.

Some light can be shed on the growth outlook for foreign trade by examining the subject from a long-term perspective and by relating the current state of foreign trade to earlier turning points in the economy. This article analyses the recent history of Finnish foreign trade from the viewpoint of goods trade, commencing from 1989 and closing with the evolution of the most recent months. This period of a quarter of a century includes many significant turning points in economic history, such as the depression of the early 1990s, the boom and bust of the domestic electronics industry, the stock market IT bubble, the international commodity boom and the financial crisis. These have all shaped the structure of Finnish foreign trade in terms of both trading partners and merchandise.

A historical review of these developments suggests that the current situation provides no such conditions for rapid export growth supporting the economy as has been seen in the earlier growth phases of economic history. As a counterbalance to the sluggishness of growth prospects for international trade and the weakness of domestic price competitiveness, no signs are discernible that would give reason to expect in the near term such export growth figures as we have seen in recent decades. However, moderate cost developments and improving economic structures could create circumstances in which the export sector stands a good chance of posting longer-term growth.

Chart 1.



Slump in exports to the former Soviet Union

In 1989, the Soviet Union was the largest market for Finnish exports, accounting for 15% of Finnish goods exports. The collapse of the Soviet Union in 1991 led to a slump in Finland's eastern trade, thus deepening the depression that had started from the financial and banking sector (Chart 2). The export contraction mirrored a weakening of demand, in particular, for means of transportation, machinery and equipment, and wood and paper products.

Worthy of note is that, despite the deep depression, the trade balance improved and turned positive. Although the value of exports dropped by 15% between the peak of 1989 and the trough of 1991, imports declined simultaneously by 24%, which is an indication of the huge role of domestic factors in causing the depression. The export value and trade surplus began to rise rapidly in the latter part of 1991 – one and a half years before GDP contraction was reversed. The markka was devalued in November 1991 and allowed to float in September 1992, which gave a boost to cost competitiveness. The trade balance improved relative to all main trading partners, except for Russia (Chart 3).

Chart 2.

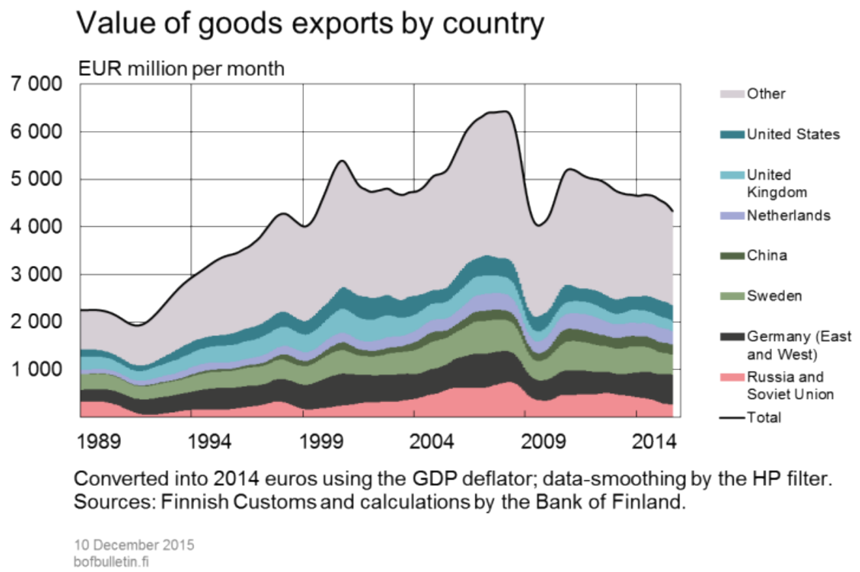
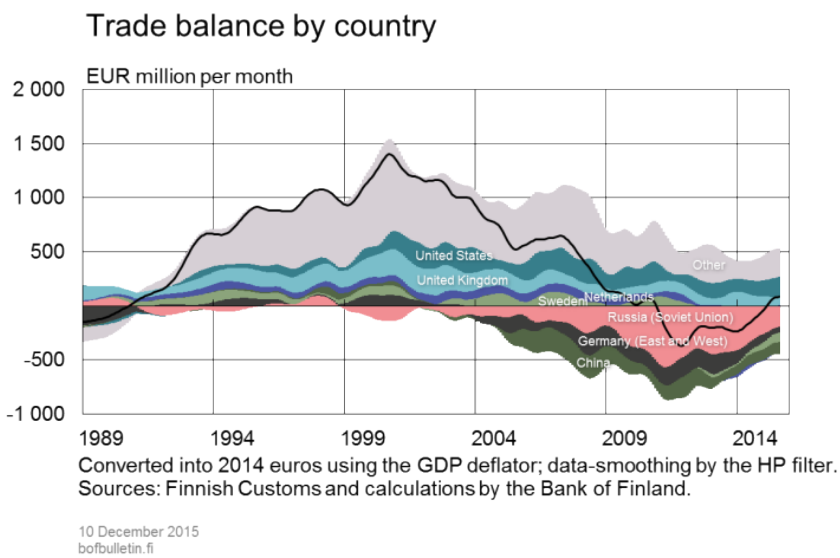


Chart 3.



Period of globalisation and rapid economic growth

Finland's trade surplus grew throughout the 1990s, achieving its peak at the turn of the millennium. Behind the surplus growth lay the overall rapid evolution of world trade, which pulled along the Finnish export industry, attended, in particular, by the wood and paper industry and electrical engineering and electronics (Chart 4). In the wake of globalisation, the trade surplus expanded, viewed by country, on a very broad front. Finnish export firms managed to create products enjoying widespread demand and capable of capturing new geographical market areas.

By the turn of the millennium, the electrical engineering and electronics industry had outstripped the forest industry as the largest export sector, its products accounting for about a third of total export value. At current prices, approximately EUR 20 billion worth of computers and electronic equipment were exported in the peak year of 2000. Similarly, at the top of its trend, the trade balance posted a surplus of EUR 1.4 billion a month.

Chart 4.

From IT bubble to financial crisis

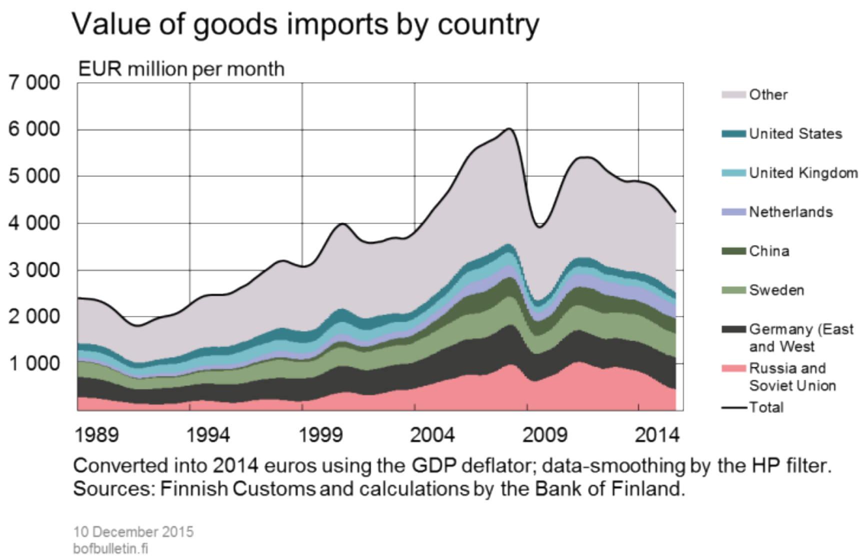
The trade surplus began to shrink at the beginning of the first post-millennium decade, albeit remaining positive until the end of the decade. The burst of the international IT bubble slowed world trade growth, bringing an end to the conquest of the world by the Finnish electronics industry, as measured by the value of goods exports.

Exports of computers and electronic equipment long remained strong, but the purchasing-power-adjusted value of exports never again climbed above the level as at the turn of the millennium. Output and export volumes of domestic information and communication technologies (ICT) continued to grow, but the prices of ICT products dropped at a rapid pace at the same time, so that euro-denominated export earnings remained subdued.

Following a short-run recession, the world market prices of many commodities embarked on a sharp rise, which continued until the onset of the international financial crisis (Chart 5). Higher commodity prices were mirrored in Finnish imports of Russian crude oil, in particular, and began to erode the trade surplus. In foreign trade statistics, industrial action in the paper industry in 2005 also stands out as a drag on exports and the trade balance, but the contraction remained short-lived.

In addition to commodity prices, factors underlying import growth in Finland included the China phenomenon and the strengthening of domestic demand. China's importance grew towards the end of the decade, and imports in particular increased strongly as from the middle of the decade, which pushed Finland's trade balance with China into deficit territory. Meanwhile, Finland's trade balance with Germany also moved into deficit. As approximately a third of Finnish imports comprises intermediate goods for the export industry, the fast import growth was also a reflection of increasing export demand.

Chart 5.



Financial crisis and electronics meltdown

The financial crisis that had originated in the global financial markets spilled over swiftly to the real economy, causing a worldwide recession, as a consequence of which the value of Finland's foreign trade collapsed. Both exports and imports contracted by more than a third, from the peak of the trend to the trough.

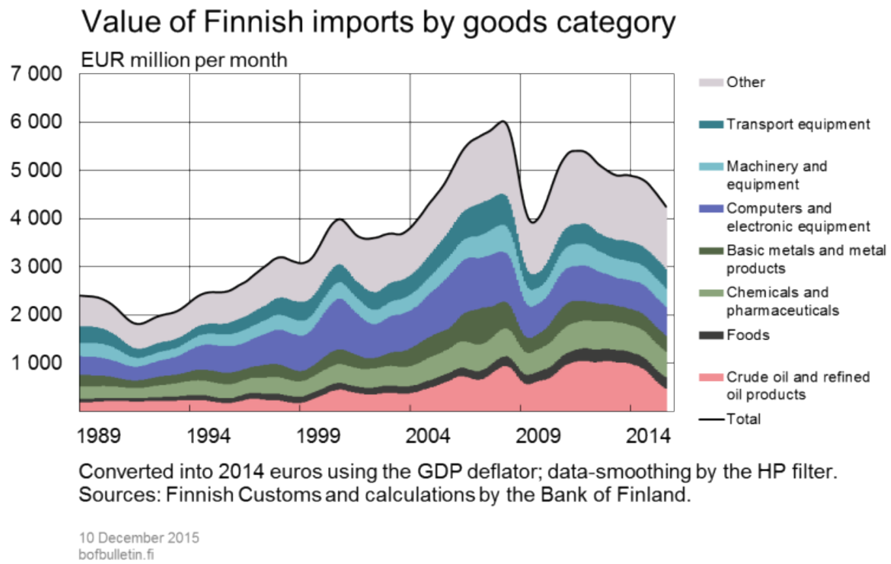
Compared with previous recessions, the foreign trade crash was considerably deeper and more broadly-based. The foreign trade value declined for all key goods categories and trading partners.

The value of electrical engineering and electronics exports plummeted by a half and has not recovered since, in contrast to other goods categories (Chart 4). Behind the meltdown lay the domestic mobile phone sector's difficulties, which were not directly linked to the financial crisis, despite taking place during the same period.

As a large part of Finnish exports has traditionally consisted of investment goods and industrial intermediate goods, export performance has been highly dependent on other countries' business cycles. Following the collapse of mobile phone exports mainly focused on consumer markets, the share of investment goods and the dependence of exports on business cycles in trading partner countries have increased further still.

Soon after the crisis, the trade balance turned negative, as commodity prices returned to an upward trajectory. Finland became a net importer of computers and electronic equipment.

Chart 6.



Recent years and latest changes

After a temporary recovery following the financial crisis, the value of both exports and imports has decreased. The falling value of foreign trade has been broadly visible in most goods categories, continuing over an exceptionally long period compared with earlier episodes of decline. Post-crisis industrial output related to high technology fell permanently, and the average productivity of domestic labour deteriorated, meaning that the cost competitiveness of the economy remained weak. The protracted period of high costs vis-à-vis competitors has dented market shares of Finnish export firms.

Despite the forest industry's difficulties, the value of forest product exports has remained relatively stable in recent years. Although the share of wood and paper products in exports has halved since 1989 to around 20%, the forest industry has maintained its position as the pillar of Finnish exports alongside the machinery and metal industry. The significance of the forest industry is also highlighted by the relatively large domestic value added share of its exports and by the fact that wood and paper products barely need to be imported thanks to domestic production.

The decline of exports and imports steepened since 2014 in response to the plunge in world market prices of commodities. Even so, the trade balance shifted into surplus particularly on account of the lower price of crude oil.

The export contraction has also been attributable to the historically extensive shutdown at the Porvoo oil refinery in spring 2015, cutting out about EUR 1 billion worth of exports of refined oil products. Correspondingly, crude oil imports also declined. The impact of oil products on the annual change of export value was approximately –4 percentage points in the second quarter. However, refined oil products are of less significance for economic output than one would presume based on their export share, as the domestic value added share of refined oil products is very small compared with other export sectors.

Lower exports have been offset by their value being boosted by higher exports of transport equipment to Germany. This increase reflects the completion of cruisers at the Turku dockyards in 2014 and 2015 and the expansion of car manufacturing at the Uusikaupunki car factory.

Exports to Russia have contracted sharply. As late as 2008, Russia was still Finland's largest trading partner in terms of both export and import value, but its share began to shrink in 2013 amid Russia's economic problems and falling commodity prices. The shares of Sweden and the United Kingdom in Finnish exports have also diminished. Germany has become Finland's most important trading partner. The Netherlands, Estonia, China and the United States have also gained in importance in recent years.

Table.

Finland's largest export and import markets in January–August 2015

Exports				Omports			
Ranking	Country	Share 2015, %	Change cf. 2008, %	Ranking	Country	Share 2015, %	Change cf. 2008, %
1	Germany	14.1	4.1	1	Germany	15.5	1.4
2	Sweden	9.7	–0.4	2	Sweden	11.7	1.6
3	United States	7.3	0.9	3	Russia	11.4	–4.9
4	Netherlands	6.7	1.6	4	China	7.2	0.2
5	Russia	5.9	–5.7	5	Netherlands	6.9	2.7
6	United Kingdom	5.1	–0.4	6	United Kingdom	3.6	0.6
7	China	4.8	1.7	7	Denmark	3.3	1.0
8	Estonia	2.9	0.8	8	United Kingdom	3.1	–1.0
9	Norway	2.9	–0.1	9	France	3.1	–0.3
10	Belgium	2.9	0.4	10	Estonia	2.8	0.6

Source: Finnish Customs.

The value of Finnish exports and imports in 2014 amounted to EUR 78 billion (38% of GDP) and EUR 79 billion (39%) respectively. Goods accounted for 73% of exports and 70% of imports, despite slight decreases in recent decades.

In 2014, the value of goods exports according to foreign trade statistics[1] was EUR 56 billion. Measured in terms of export value, the most important domestic export products

1. The Finnish Customs foreign trade statistics provide an abundance of details of goods exports and imports. Foreign trade data have been collected monthly, broken down into nearly 14,000 goods categories by country of origin and destination. The statistics exclude transit goods, i.e. transports via Finland. For enabling longer-term reviews, earlier foreign trade statistics were aggregated and amended so as to correspond to current goods classifications. Annual foreign trade statistics for 1989–1995 were disaggregated at monthly level using the Denton–Cholette method. In order to smooth out strong monthly variations, the calculations made use of the Hodrick–Prescott filter. Euro-denominated export and import figures were converted into 2014 euros using the GDP deflator.

comprised wood and paper products (20% of goods exports), basic metals and metal products (14%), computers and electronic equipment (12%), refined oil products (8%) and transport equipment (6%). The most important import products were crude oil and refined oil products (18%), computers and electronic equipment (13%), chemicals and pharmaceuticals (12%), transport equipment (8%) and machinery and equipment not classified elsewhere (8%).

Tags

- foreign trade
- Finland