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The abolition of bilateral trade and subsequent collapse of Soviet markets were a serious loss to East European countries and Finland. In this report the significance of Soviet markets and their collapse and the ensuing adjustment process in the export industries of two countries, Finland and Czechoslovakia are analyzed up to the end of 1992.

In both countries, many industries, especially the metal and engineering sector, relied on Soviet markets although the dependence was much greater in Czechoslovakia. Simultaneously with the loss of Soviet markets both economies entered a recession of unprecedented depth, the causes of which were differed in the two countries. Czechoslovakia embarked upon a process of dismantling state-controlled economic structures, introducing market reforms (price and tax reforms, privatization) and cutting public spending. All this, together with the turbulence in Soviet markets, precipitated a severe domestic recession.

In Finland several adverse trends during the 1980s culminated in 1991 in a sharp contraction in output, which was followed by soaring unemployment and a slump in domestic economic activity. The markka was devalued, and this helped to boost exports, the only sector of the economy which grew in 1991–92.

Table 1 **Macroeconomic Indicators for 1989–92**

	1989	1990	1991	1992
GDP growth, %				
Czechoslovakia	1	-0	-16	-13
Finland	5	0	- 7	- 2
Unemployment, %				
Czechoslovakia	-	1	7	6
Finland	3	3	7	13
Inflation, %				
Czechoslovakia	1	10	59	7
Finland	5	6	4	3

Sources: Suhdanne 1992/4, Taloudellinen katsaus, 1991, Klacek and Hrnčíř, 1993, p. 51

In Czechoslovakia the decline in output and real wages was sharper and inflation higher than in Finland but employment was maintained at a high level by the state. In autumn 1992 the unemployment rate was below 3 % in the Czech republic, 10 % in Slovakia (Pick and Turek, 1993, p. 11) but 16 % in Finland. As market structures develop unemployment will inevitably grow also start to rise in the Czech lands and Slovakia.

Differences in macroeconomic performance in Finland and Czechoslovakia are shown in Table 1.

Trade arrangements with the Soviet Union

Finland's manufacturing industries operated mostly in a competitive environment both at home and abroad but in the trade with the Soviet Union a system resembling that of intra-Comecon trade was created in the early 1950s. The system lasted until 1990 and was characterized by the following features:

- the use of rouble clearing accounts as a means of payment, convertible currencies in exceptional cases;
- the volume and composition of trade was outlined in five-year trade agreements and annual protocols;
- bilateralism, which required that the trade be balanced within a stipulated period; and
- participation of the state and central bank in the trade and payment arrangemets.

This system was not as rigid as the intra-Comecon trade in stipulating the quantities of goods to be delivered by enterprises but, if certain items were included in the protocols, manufacturers could be sure that sales prospects were fairly good as Soviet buyers had to fulfil the import plan. Though there was some scope for competition under the system, in many cases it tended to secure Finnish exporters a good position in Soviet markets. For instance, Finnish companies accounted for more than 70 % the Soviet Union's total paper imports and 40–60 % of its imports of paper and wood-processing equipment while for ships the corresponding share was 20 %. Finnish exporters were also able to obtain quite high prices for their products.

From 1948, the Czechoslovak industry operated in an environment in which effective competition was lacking both at home and abroad. Only about 30 % of exports typically went to competitive markets but even in this case manufacturers had little contact with end users. It is clear, that the high dependence on non-competitive Comecon markets weakened the competitiveness of export industries. As a result, the share of Czechoslovakia in world trade constantly diminished.

The same assertion has also been made concerning Finnish manufacturing industries. For instance, in the Economic Bulletin for Europe it is claimed that the bilateral trade had distorting effects on the behaviour and competitive performance of Finnish firms and sectors, making it difficult for them to redirect exports to western markets. It is also asserted that the clearing trade contributed to the deterioration of Finland's manufacturing competitiveness (ECE Economic Bulletin for Europe, vol. 44, 1992, p. 111 and p. 124). To what extent this holds true will be discussed later.

Table 2 **Structure of Finnish and Czechoslovak Exports to the Soviet Union in 1989**

	Finland %	Czechoslovakia %
Food, beverages, tobacco	2.5	0.9
Chemicals	6.7	5.3
Pulp and paper	21.9	0.1
Iron, steel	1.8	5.8
Machines and equipment	50.0	63.8
of which: telecommunications		
and electric equipment	11.1	8.0
transport equipment	24.8	24.2
Textiles, clothes	3.9	8.2
Footwear	1.9	7.5
Other	11.3	8.4
Total	100.0	100.0

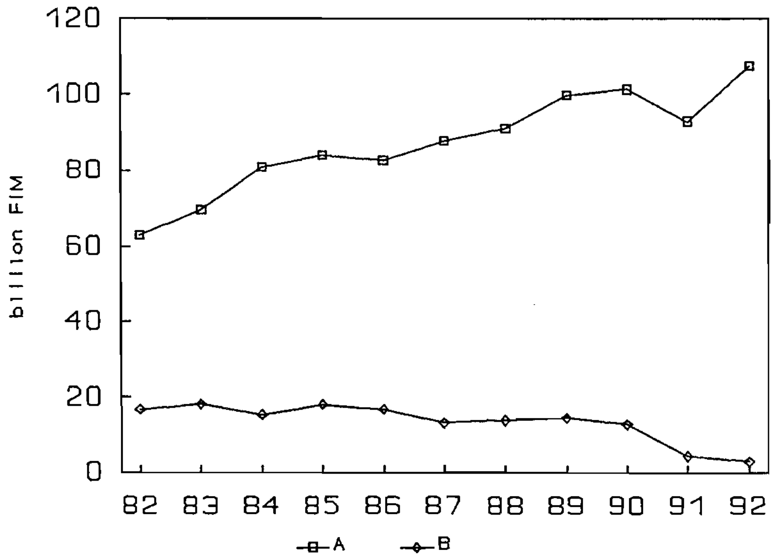
Sources: Ulkomaankauppa 1989, Collapse of the former Soviet Union..., 1993

The level of Czechoslovak exports to the Soviet Union was 3–4 times higher than Finland's exports but in per capita terms the difference was only about 20 %. Czechoslovakia was substantially more dependent on Soviet trade than Finland, the relative shares being 34 % and 15 %, respectively, in 1988. The structure of exports to the Soviet Union showed striking similarities in both countries (see table 2). Though it was fairly well diversified, machines and equipment tended to dominate. As regards engineering exports, there was no marked specialization in Czechoslovakia whereas ships were the major item in Finland. The second largest commodity group was paper in the case of Finnish exports and consumer goods (clothes, footwear) in the case of Czechoslovak exports.

Soviet foreign trade started to stagnate after 1985, and this was felt immediately in Finnish exports although there was a temporary rebound in 1988–89. In Czechoslovakia, exports to the Soviet Union peaked in 1987 but the share of Soviet trade declined rapidly thereafter, to 24 % in Czechoslovakia and 13 % in Finland in 1990.

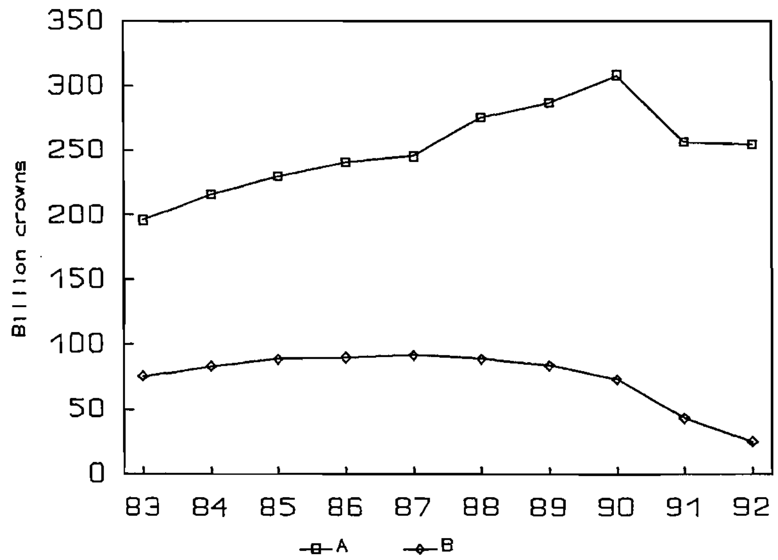
In that year, proposals for dismantling the bilateral trade system within Comecon became increasingly more frequent. The trading partners benefitting from this system, including Finland, were not, however, prepared for such an abrupt change as that which took place in January 1991. These countries were especially hard hit by the collapse of the Soviet trade. Finnish exports plunged by approximately 70 % and Czechoslovak exports by over a half (see Vneshnyaya torgovlya 4–5, 1992, pp. 48–49). The share of Finnish exports going to the Soviet Union declined to 5 %. In Czechoslovakia the change was not as abrupt, the share remaining at 17 %. This was attributable to the inertia of the old system. Deliveries agreed upon earlier continued in 1991 although there was no certainty of receiving any payment for the goods. Thus in Czechoslovakia the decline continued in 1992 while in Finland the situation had stabilized by then.

Figure 1 **Finland: Total exports, 1982–91**



A Total exports
B Exports to the Soviet Union

Figure 2 **Czechoslovakia: Total exports 1983–92**



A Total exports
B Exports to the Soviet Union

Both in Finland and Czechoslovakia total exports grew till 1990, the decline in Soviet markets affecting overall figures only in 1991. In both countries, this collapse coincided with other adverse economic developments, leading to a deep recession. A major task in both countries was to bring about a revival in exports after the loss of Soviet markets. In Finland, where the markka had been overvalued for a long time, a devaluation was implemented in late 1991, and September 1992 the markka was floated, whereupon it depreciated sharply. This, together with intensified marketing efforts, helped to boost exports, which grew rapidly in 1992 and regained level of 1990.

In Czechoslovakia the basic problem was systemic change. In foreign trade this entailed partial liberalization and internal convertibility of the crown, including three successive devaluations in 1990 (Hrnčíř, 1992, p. 26). As a result the crown became clearly undervalued and no further devaluations took place in 1991–92. Thus both in Finland and Czechoslovakia price competitiveness was fairly good when faced with the necessity of finding new markets. In the case of Finland the change was especially radical as the fall in the value of the markka was accompanied by exceptionally slow inflation (a consequence of the severe domestic recession).

Developments in exports by commodity groups

To assess the impact of the collapse in Soviet markets on the economies and foreign trade of Finland and Czechoslovakia the situation has to be analyzed by industries and commodity groups. Some industries have barely recovered at all while others have adapted with relative ease to new markets. In the following, developments in Finnish and Czechoslovak exports are analyzed by SITC grouping.

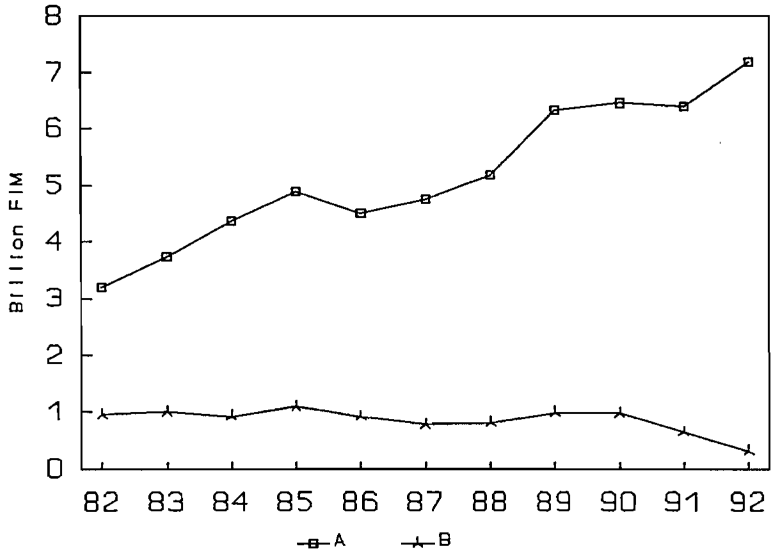
Food, live animals, beverages, tobacco (SITC 0 and 1) played a minor role both in Finnish and Czechoslovak exports. In the early 1980s, as much as 60 % of Finnish food exports went to the Soviet Union and even in 1990 the share was nearly 1/3. The dependence of Czechoslovak companies on Soviet markets was much lower for this group of products.

Rude materials, mineral fuels, electricity, animal and vegetable oil (SITC 2–4) were also of minor significance except for pulp (SITC 25), which will be discussed in connection with paper exports.

Chemicals and related products (SITC 5) typically accounted for of 5–7 % of both countries' total exports. Soviet markets took 15 % of Finnish and 11 % of Czechoslovak exports in this group before the collapse.

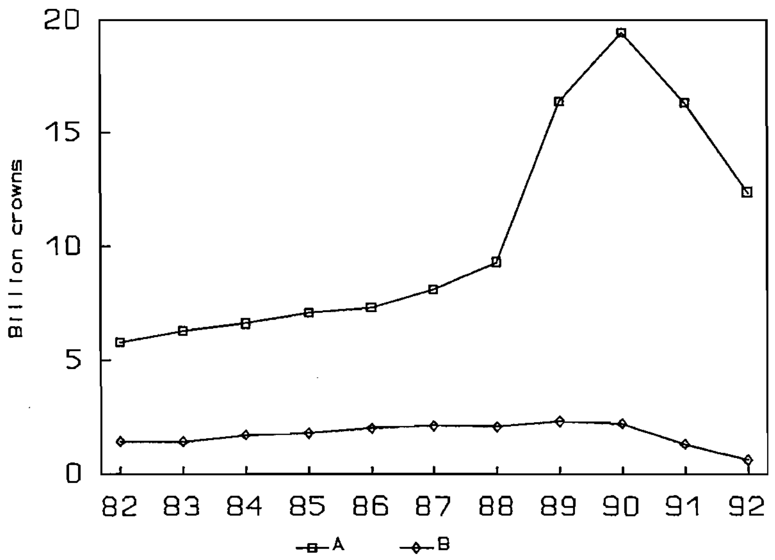
The Finnish chemical industry recovered rapidly from this loss in 1992 while in Czechoslovakia exports continued to decline in that year even though Soviet markets had already become less important prior to the collapse.

Figure 3 **Finland: exports of chemical products 1982–92**



A Total exports
B Exports to the Soviet Union

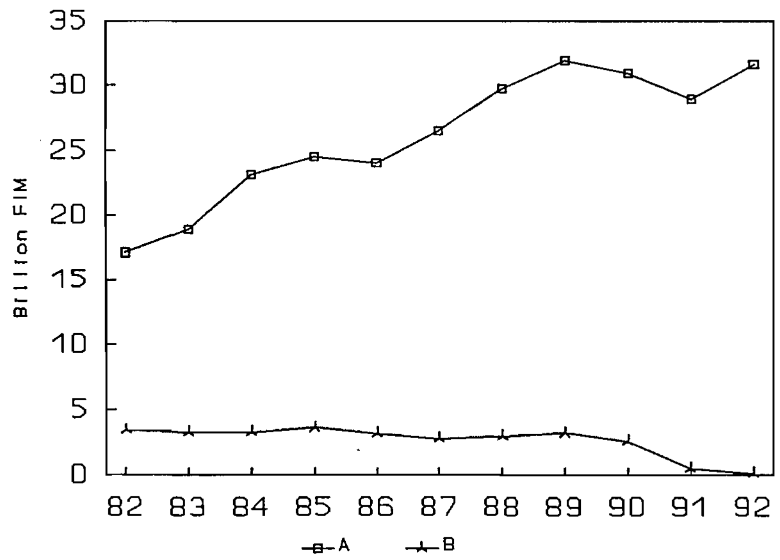
Figure 4 **Czechoslovakia: exports of chemical products 1982–92**



A Total exports
B Exports to the Soviet Union

SITC 6 includes such important items as paper, iron and steel. For Finland, a major pulp and paper supplier in the world markets, Soviet markets still took one-tenth of total exports in 1989. Sales to these markets collapsed by 80 % in 1991, and this was the main reason for the overall decline in pulp and paper exports (-6 %) in that year. The losses were, however, rapidly made up for in 1992 when growth in value terms was 9 %.

Figure 5 **Finland: exports of pulp and paper 1982–92**



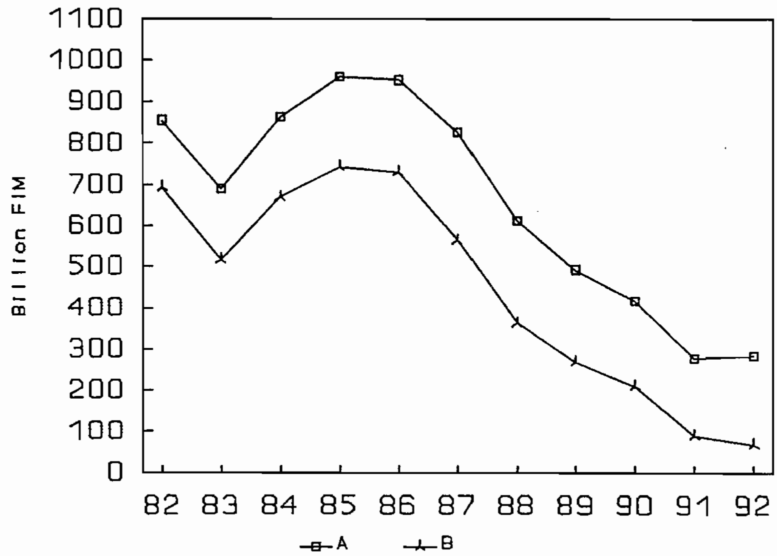
A Total exports
B Exports to the Soviet Union

Czechoslovakia has also exported paper but not to Soviet markets. It is a major exporter of iron and steel, more than a quarter of which went to Soviet markets in the 1980s. This share had declined to 11 % in 1990. The collapse of Soviet markets and domestic recession freed iron and steel capacity. Exports to western markets expanded significantly, the share of iron and steel in total Czechoslovak exports rising from 11 to 17 %. Future market prospects are bleak in view of the general overcapacity in Europe.

Finland also exports considerable quantities of iron and steel but Soviet markets were always of marginal importance (5–6 %).

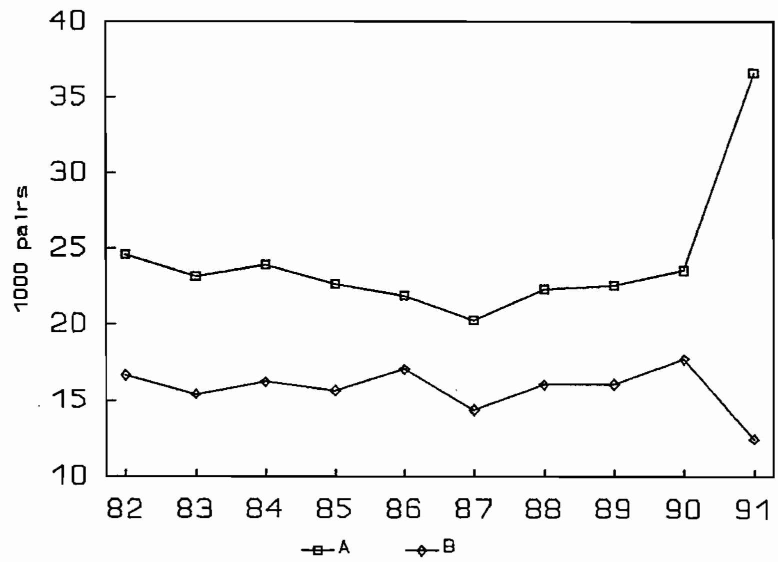
In the case of both clothes (SITC 84) and footwear (SITC 85), Soviet markets were of vital importance for both Finland and Czechoslovakia. Soviet purchases of Finnish clothes and footwear started to decline in 1986, which immediately reduced output in those industries. The collapse in 1991 meant a further weakening of these industries, the exports of which did not show any signs of recovery in 1992 in contrast to most other industries. Enterprises reacted by cutting capacity or shifting production abroad, e.g. to Estonia.

Figure 6 **Finland: exports of footwear 1982–92**



A Total exports
B Exports to the Soviet Union

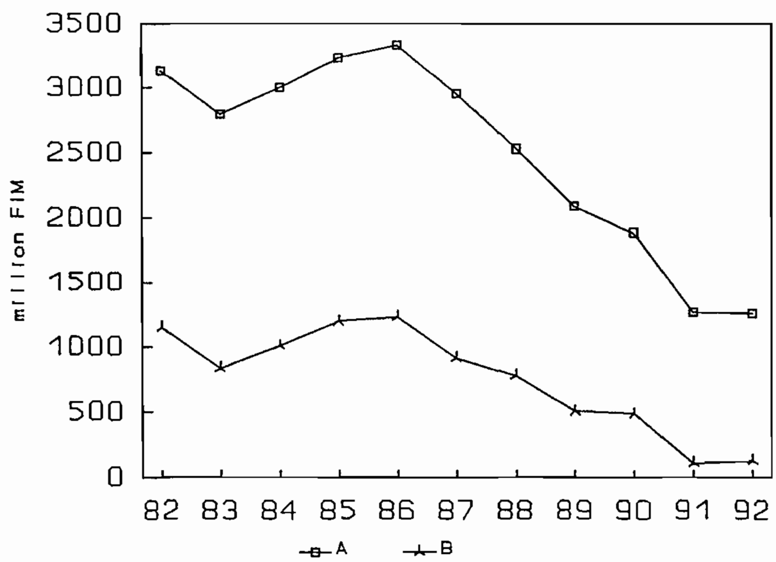
Figure 7 **Czechoslovakia: exports of leather shoes 1982–91**



A Total exports
B Exports to the Soviet Union

In Czechoslovakia exports in both groups increased slightly up to 1990. Developments since 1991 indicate that Czech and Slovak enterprises have found new markets. These industries, which have long traditions in Czechoslovakia, are more adaptable than the engineering industries and they have benefitted from the relatively low level of wages. In Finland,where deliveries to the Soviet Union were based on fairly standardized mass production, finding new markets will be very difficult in view of the relatively high cost level.

Figure 8 **Finland: exports of clothes 1982–92**



A Total exports
B Exports to the Soviet Union

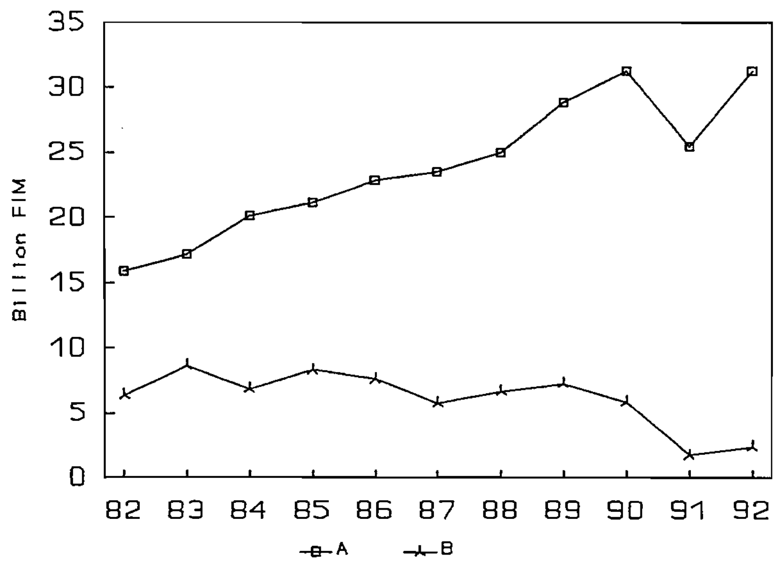
Engineering Exports

As regards machinery and transport equipment (SITC 7), Soviet markets were of major importance to both Finnish and Czechoslovak engineering industries. Much of the capacity in both countries was given over to meeting Soviet orders. In Finland this dependence was initially established during the war reparations period from 1945 to 1951, when the Soviets required Finland to pay reparations not in the form of its traditional export items such as paper and cables but rather in the form of machines and transport equipment. To meet these demands the capacity of Finland's engineering industries had to be expanded threefold, shipbuilding by as much as six times (Eronen and Susiluoto, 1980, pp. 12–13). At the beginning of the 1950s, when the reparations had been completed, Finland was threatened with substantial excess capacity in these industries. The Soviets then agreed to continue purchasing Finnish machines and equipment on commercial terms. This undoubtedly provided the Finnish engineering sector with a strong boost and subsequently it was also able to enter western markets. In the early 1980s, about

40 % of Finnish engineering exports still went to the Soviet Union but fortunately most of the outlets were in competitive markets, either domestic or western. In the late 1980s, the industry's western orientation was strengthened continually, and in 1990 the share of the Soviet markets was only 19 %.

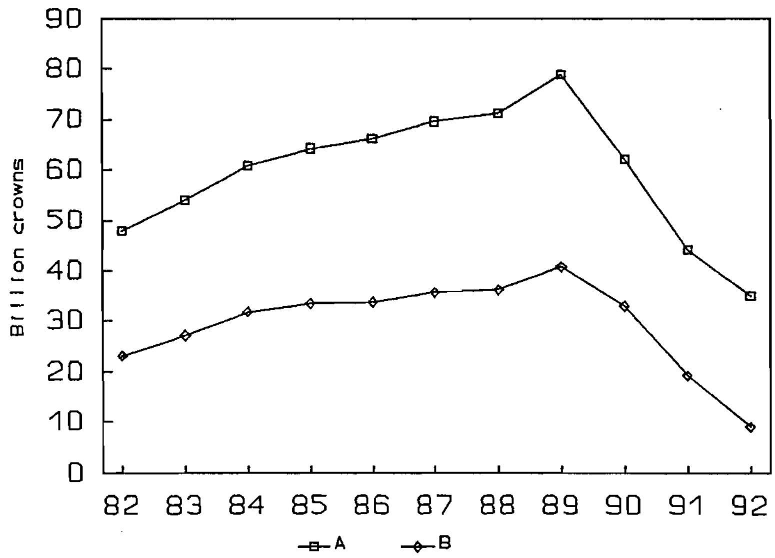
In Czechoslovakia the diversified engineering industries were to a large extent subordinated to the needs of the Soviet and Comecon economies after 1948. The share of the Soviet Union in total exports was not substantially higher (40 %) than it was in Finland in the peak years but the problem was that only a small part of Czechoslovak output went to truly competitive western markets.

Figure 9 **Finland: exports of machines and equipment 1982-92**



A Total exports
B Exports to the Soviet Union

Figure 10 **Czechoslovakia: exports of machines and equipment 1982–92**



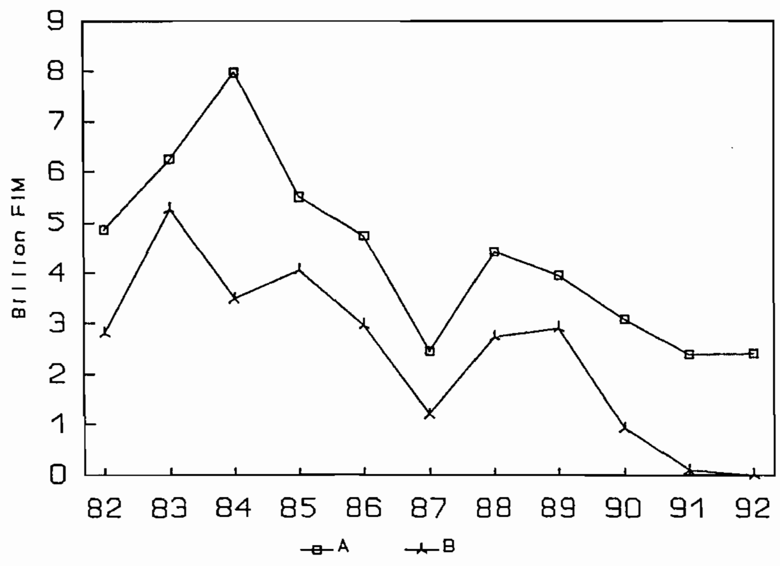
A Total exports
B Exports to the Soviet Union

Dependence on Soviet markets varied considerably between commodities. In Czechoslovakia the range of engineering products manufactured primarily for Soviet purposes was considerably wider than it was in Finland.

Finland is one of the world's leading manufacturers of paper machines. Soviet markets took 10–20 % of Finnish exports up to 1986 but subsequently these markets started to decline. 1991 was a bad year for Finnish paper machines but this was no longer related to the disintegration in the Soviet Union.

Since the period of war reparations ships have been a major Finnish export item, largely thanks to Soviet orders. This market collapsed already in 1989, which was reflected immediately in output. Though the industry has been able to win orders in other markets it has not been enough to compensate for the losses.

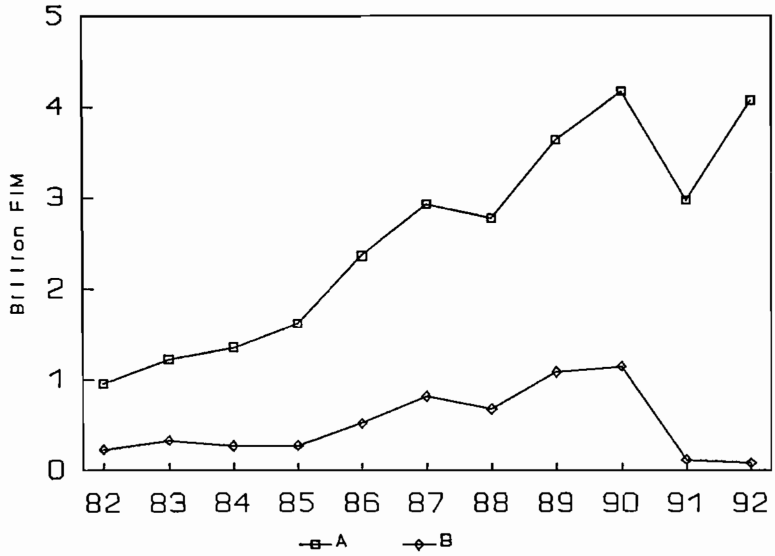
Figure 11 **Finland: exports of ships 1982–92**



A Total exports
B Exports to the Soviet Union

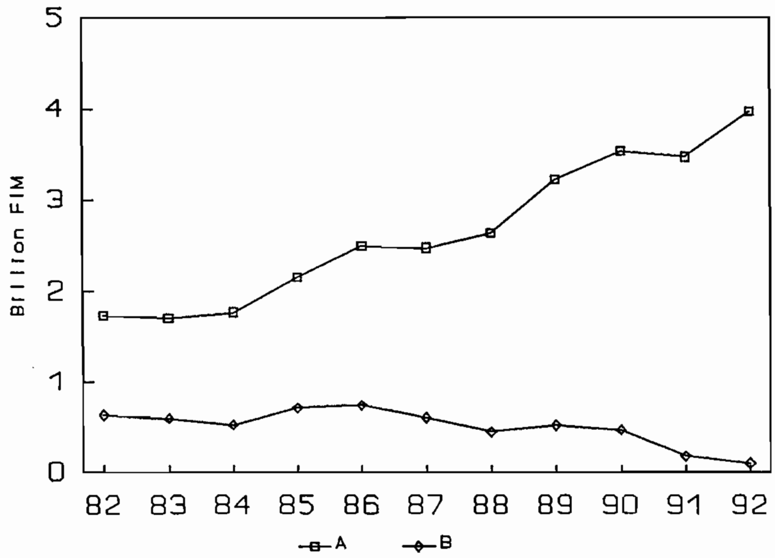
Telephone, radio and TV equipment was an expanding group in Finnish exports and, contrary to overall trends, the share of Soviet markets increased up to 1990, exceeding 1/4. The subsequent contraction was exceptionally sharp but much of it was already compensated for in 1992 in other export markets. In the case of other electric equipment, Soviet markets declined in importance after 1986 and the collapse was not very serious for the industry.

Figure 12 **Finland: exports of telephone, radio and TV equipment 1982–92**



A Total exports
B Exports to the Soviet Union

Figure 13 **Finland: exports of other electric equipment 1982–92**

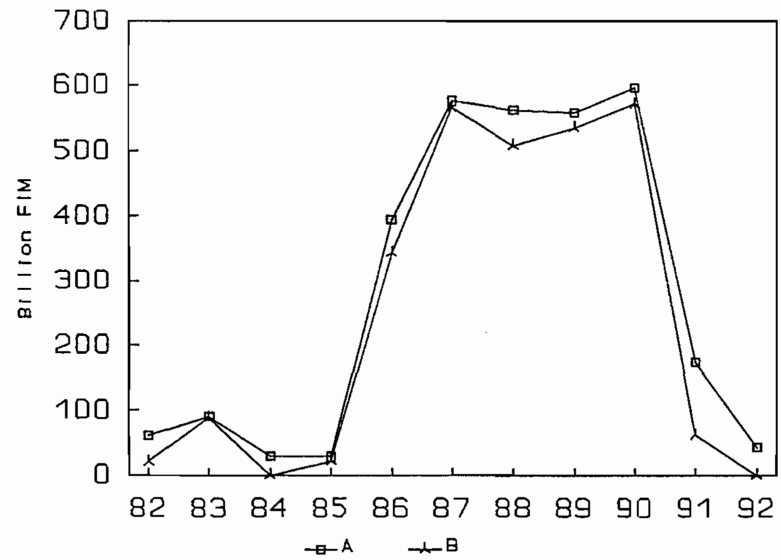


A Total exports
B Exports to the Soviet Union

Railway wagons were the item most dependent on Soviet markets. The Soviets had previously purchased rolling stock from Czechoslovakia but they wanted more competition and therefore suggested that the Finns start manufacturing them as well. The state-owned Rautaruukki company, which was deeply involved in eastern trade, seized on the idea and built a wagon factory at Otanmäki, a depressed former mining town in Northern Finland.

Over 90 % of output went to the Soviet Union but since its disintegration only a few alterative outlets have been found.

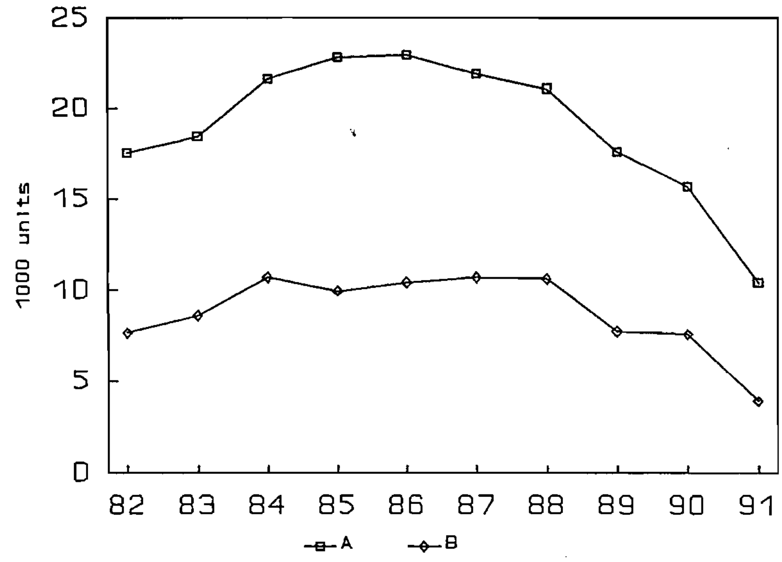
Figure 14 **Finland: exports of railway wagons 1982–92**



A Total exports
B Exports to the Soviet Union

In Czechoslovakia the range of products depending on Soviet markets was substantially wider. The dependence was especially high among locomotives, railway wagons, electrotechnical and data processing equipment, pumps and arms. Among export products not dependent on Soviet markets were cars and tractors. It is clear, that the Czech and Slovak engineering companies face much more difficult adjustment problems than their Finnish counterparts. The figures on dependence on Soviet markets (40 % and 27 %, respectively in 1988) do not reveal the different situation that prevailed at the company level: Czechoslovak enterprises did not have much choice in selecting final purchasers as their deliveries were tied by intergovernmental agreements. Soviet-Finnish trade was also conducted on the basis of intergovernmental agreements but this did not imply any obligations at the firm level, as companies were free to choose where to sell. In the heyday of the trade Soviet markets were attractive to exporters though risk-averse companies were careful not to rely too much on one market only. And even where this was not the case, the signs of stagnation that began to emerge in 1986 compelled firms to look for growing markets elsewhere.

Figure 15 **Czechoslovakia: exports of trucks 1982–92**



A Total exports
B Exports to the Soviet Union

According to a survey carried out among Finnish engineering companies, 16 % of them reported they anticipated difficulties in Soviet markets as early as 1985. However, most of the companies surveyed did not realize what was in store until 1989–90, and the abruptness of the collapse in 1991 came as a shock to many.

An active search for new markets started but success was not achieved immediately. Over a third of the engineering companies surveyed had to cut output and more than 40 reduced their workforce. In many cases product adaptation was necessary as technical specifications required by the Soviets differed from western standards. About a third of the companies made adaptations in quality and techniques when they entered new markets, most of which were in Western Europe (Eronen and Orpana, 1993).

Judging by the upsurge of exports in 1992 the adjustment of Finnish engineering industries has been fairly successful. Only those branches that specialized in Soviet markets, ships and railway wagons and certain others, have not recovered.

Table 3 **Selected Czechoslovak engineering exports and the share of the Soviet Union in 1987**

Item	Value of Exports, mill. crowns	Share of the Soviet Union %
Steel rolling equipment	2303	95
Locomotives	2875	94
TV, radio and telecommunication equipment	1583	82
Pumps, compressors	3077	79
Railway wagons	..	75
Computers	1089	73
Motorcycles, scooters, mopeds	975	70
Bulldozers, cranes	2682	65
Metal working machines	3298	52
Electric motors, transformers, generators	1322	52
Trucks	10187	42

Source: Collapse of the Former Soviet Union Economy and Markets and its Impact on Czechoslovak Economy and Foreign Economic Relations (in Czech), Special Report, 1993.

Conclusions and future prospects

Although both Czechoslovakia and Finland had similar trade agreements with the Soviet Union, the Czechoslovak export industries were, especially in the late 1980s, much more dependent on Soviet markets. Their chances of adjusting to the sudden loss of Soviet markets were not equal. Finnish companies – even those dependent on Soviet customers – were used to operating in a competitive environment and were soon able to find markets elsewhere. This process was accelerated by the devaluation of the markka in November 1991 and the depreciation of the currency after it was allowed to float in September 1992. The rapid growth of exports, especially in the engineering and electrotechnical sector, refute the assertion that extensive trade with the Soviet Union impaired the competitiveness of Finnish manufacturing industry.

In Czechoslovakia the situation was much worse. The collapse of Soviet markets meant a protracted decline in total exports and a shift in the structure of exports in favour of lower value added products. Hardest were hit engineering companies specilized in former Comecon markets; only about 1/4 of the losses were compensated for in 1991. Exports were increased in commodity groups where price was the key competitive advantage, such as iron and steel (in SITC 6), textiles, clothes, footwear, food and paper.

As can be seen in table 4, the change in the structured Czechoslovak exports was significant in 1989–92 while in Finland it was negligible.

Part of the Czechoslovak success has been achieved in markets with excess capacity (steel), which does not augur well for the future.

Table 4 **Structure of Czechoslovak and Finnish exports in 1989 and 1992**

Commodity Group, SITC	Czechoslovakia 1989	1992	Finland 1989	1992
	- % -			
Food, beverages, tobacco (0–1)	5	9	2	3
Raw materials (2)	4	6	12	9
Fuels, electricity (3)	5	4	1	3
Chemicals (5)	8	10	6	7
Basic manufactures (6)	22	36	42	43
Machines, equipment (7)	44	22	29	29
Others (4,8,9)	12	13	8	6
Total	100	100	100	100

Sources: Ulkomaankauppa 1989, 1992, Jahrbuch der Aussenhandels der Tschechoslovakei 1982 to 1991, Bulletin FSU, 1992

The loss of Comecon markets coincided with a deep domestic recession in Finland and Czechoslovakia. In Finland, however, the slump in exports in 1991 turned out to be transitory as alternative markets were found in most industries. The loss of Soviet markets did not lead to important capacity cuts or structural changes in the Finnish manufacturing industries. The reasons for Finland's economic problems are to be found elsewhere.

In the Czech and Slovak republics the situation is much more complicated and the adjustment problems of a different magnitude. As both Soviet and domestic markets are likely to remain stagnant at best re-orientation to the west is essential. An active search for new markets and cooperation partners has started. Foreign firms have shown interest in manufacturing and marketing cooperation, especially with Czech companies. For instance, in the engineering and electrotechnical industries new western partners include such firms as the German companies Siemens, AEG, Deutsche Babcock-Borsig, Bosch, Mercedes Benz and Alcatel Standard Electric, the French company Cegeleg, the Italian company Cagiva, the Swiss company Secheron SA, the Finnish company Kone, the American company Stanley Works, and the Japanese companies Mukojima and Nisho Iwai etc (Collapse of the..,1993).

So far, these partnerships have not been able to give any decisive growth impulses to these industries to compensate for the loss of Comecon markets. The recession in the domestic economy continues and reforms such as privatization have not yet encouraged investments. The separation of the Czech and Slovak republics threatens to sever traditional links between companies and is adding to confusion in the market.

The capacity cuts, now being implemented seem irreversible. Take a far example, the engineering industries. In 1989, they employed 650 000 people and exported 1/3 of their total output, 2/3 of which to the former Comecon area. Thus only 1/10 of their output was sold in competitive markets. Most of the capacity is in the Czech republic; in Slovakia much of the capacity is to be found in the armaments industry. In the worst-case scenario up to a half of capacity could vanish (and indeed part has partly already done so). However, some products are or can be made competitive in world markets.

The situation is worse in the electrotechnical industry, which employed 150 000 people in 1989. Its isolation from world markets is illustrated by the fact that only 5 % of its output was sold outside the Comecon area. By the end of 1992, the production had been halved and employment cut by 1/3.

The difficult adjustment process of Czech and Slovak manufacturing industries to competitive markets has begun. Much of the capacity and employment formerly tied up producing for Soviet markets is vanishing. Major changes in industrial structure in favour of lower value added products are under way. This will adversely affect, for example, the obsolete part of the engineering and electrotechnical industries, but on the other hand, these industries, which combine traditionally a high level of know-how with a relatively low wage level, enjoy a comparative advantage, as revealed by a study based on 1989 data (see Klacek and Hrnčíř, 1993, p. 59). This, together with the influx of foreign capital and know-how, will undoubtedly create a new competitive edge for Czech and Slovak manufacturing industries.

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