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The effects of economic sanctions on Finnish exports and economy

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<p>The goal of this study is to observe the economic sanctions issued by the European Union and the counter-sanctions issued by Russia, and their effects on the Finnish economy and Finnish foreign trade.</p> <p>The background of the economic sanctions issued by the European Union and Russia is explained through the crisis in Ukraine. Both parties laid down sanctions because of the annexation of Crimea. This research will focus on the crisis itself and also to the effects that it has had on the Finnish economy and furthermore, to other European and non-European countries.</p> <p>Economic sanctions and embargoes, throughout the history, have been an instrument to pressure various parties. It is questionable if they work or not.</p> <p>This thesis aims to give the reader a general idea of what, why and when events happened and what were the results of those actions. The crisis in Ukraine has been maybe the most serious conflict in recent history and it is important to understand from where it originated and what are the effects on the world economy. Also this study discusses which are the possible solutions and how they could be achieved.</p>	
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1. Introduction

1.1 Research issue

The research will focus on the effects of Finnish products export to Russia, before and after the EU's Russia sanctions and Russia's counter sanctions. The research question is important because Finnish economy has been suffering since 2014. The biggest direct impact of the sanctions is on dairy products. In 2013 dairy products accounted for over 80% of Finland's food export to Russia. (Ministry of Finance, September 2014). The most important question is how Russia's counter-sanctions have affected Finnish exports to Russia?

Russia has traditionally been a vital trade partner with Finland and it is important to research how Finnish economy suffers because of the current situation and how Finland could overcome the effects of the sanctions.

The topic was chosen because the author has always been interested in history, especially military history in the 20th and 21st century, and how various crises have affected the global economy. The idea for the research arose in the summer of 2014 when the so called "Putin-cheese" (Putin-juusto) came to the Finnish grocery stores. Because of the Russian counter-sanctions, Oltermanni-cheese produced in Finland was sold in Finnish stores and almost 2 times cheaper than the regular cheese. (Koski, 2014)

1.2 Research method

- "The finding and gathering (or generating) of materials that the researcher will then analyse" (Straus, 1987, p.20).

When researching an event which has happened recently and is still ongoing, there is a possibility, that there are not much relevant books published yet and that is why the research has to rely on articles, statistics and other publications.

The research method that was chosen for this thesis is desk research. There is no primary research done such as interviews etc. Desk research is a method that collects and examines easy to get and already existing materials and information, such as: magazines, internet articles, information in newspapers and company and government records. (Cambridge Dictionaries Online, 2013)

During the research process, which started last fall, it has been important to keep up with the current situation. The research relies heavily on news articles and studies made by other researchers and aims to give the reader a clear picture how the situation has evolved and what are the reasons behind the sanctions. It is important to understand how everything started and also what kind of history Finland has in foreign trade. Relevant statistics has been used to explain how Finnish economy and also its neighboring countries has suffered because of the sanctions issued by Russian as well as sanctions issued by the European Union.

1.3 Background of the Ukrainian crisis

The beginning of the Ukrainian crisis can be traced back to 21st of November 2013 when then President Viktor Yanukovich failed to sign a trade agreement with the European Union. Yanukovich had the option either to sign a trade association agreement with the EU, or he could take a \$15bn loan from Russia and move the country to a “Eurasian Union”, with Belarus, Kazakhstan and Russia. Under the pressure from Russia he decided not to sign the trade agreement with the EU. This decision started protests in the Independence Square (the Maidan) in Kiev and Yanukovich tried to end them with force. Thousands of people joined these protests and when the clashes grew even more violent, it united moderates, liberals, technocrats, pro-European and far-right nationalists. (Yuahan, April 2014)

In December 2013 the protest escalated, gathering around 800,000 people to Kiev. At the same time President Yanukovich met with Russian President Vladimir Putin in Moscow. There were three key results in the meeting;

- The price of natural gas drops one-third; the Russian Gazprom and the Ukrainian Naftogas signed a new gas contract where the price of Russian sold gas will drop one-third to 199€ per thousand cubic meters. The reductions were important,

since Ukraine acquired the majority of gas from Russia. The old contract from 2009, signed by the then Prime Ministers Yulia Tymoshenko and Vladimir Putin was expensive. This unfavorable gas contract was also the official reason of Tymoshenko's jail sentence.

- Ukraine will receive a loan of more than €11bn; Russia announced that they would buy Ukrainian bonds totaling €11bn. The acquisition was important for Ukraine, as the country's economy was at the point of collapse. Because of the financial crisis, Ukraine's economy collapsed 15% in 2009. It was partly due the low market price of metals, which is a major export product for Ukraine, but also because of poor management of the economy and corruption.
- Yanukovich keeps up his appearance; at the time of the meeting the protests against Yanukovich continued in Kiev. (Niemeläinen, 2014)

In January 2014 the parliament enacted laws forbidding demonstrations. The crisis also claimed its first casualties when two people were killed by gunshots and third died after falling off from a gate at the demonstration site. Protesters also started to invade parliament buildings in western Ukraine. At the end of January 2014 the Prime Minister Mykola Azarov resigned and the parliament set aside the laws prohibiting demonstrations. (Hanhivaara, Wallius, 2014)

In the mid- February 2014 a group of protestors tried to march to the parliament building but the police prevented the march and the special forces attacked which resulted the deaths of at least 18 people. After these events Kiev saw the worst violence in almost 70 years when 88 people died in the clashes during two days. President Yanukovich and three opposition leaders signed an agreement, conveyed by the EU, to end the crisis. The agreement stated that the country will hold early presidential elections and there is to be formed a coalition government. The agreement unraveled quickly the President Yanukovich went missing, the protesters took over presidential buildings and the parliament ousted Yanukovich, who later appeared in public in Russia. The presidential duties were given to the chairman of the parliament, Oleksander Turchynov, who was also an ally to opposition leader Yulia Tymoshenko. At the end of February a group of pro-Russian gunmen seized the regional parliament located in Simferopol and a day after that, Russian army troops surrounded two airports in Crimea. (Heiskanen, 2015)

At the beginning of March 2014 the Federation Council of Russia approved President Putin's proposal and authorized the military action on Ukrainian territory. The proposal did not mention a word about the Crimean peninsula, but the referral was the "Ukrainian region". Ukraine's acting President Turchynov responded by commanding the Ukrainian armed forces to an alarm state. Ukraine also asked the European Union, NATO (North Atlantic Treaty Organization) and the United States to consider ways how the territorial integrity of Ukraine could be protected. The situation in Crimean peninsula escalated all the time and Ukrainian sources said that Russia had sent thousands of new troops to the area. At the same time, violent unrest which opposed the provisional government, expanded to other parts of eastern Ukraine. In Donetsk, the demonstrators raised the Russian flag on top of the regional administration building. Also in Kharkov the pro-Western and pro-Russian protesters clashed. (Hakala, 2014)

Finnish President Sauli Niinistö told that the crisis in Crimea did not have a direct impact on Finland's security policy and solving the crisis was to be regarded as a clear discussion between the European Union and Russia. (Kauhanen, 2014)

Several weeks after the annexation of Crimea, the United States and the European Union imposed sanctions against Russia. Most of the sanctions were limited to Putin's associates and people who were linked to the events in Crimea. 33 Russians and Ukrainians were blacklisted by the EU and the US sanctioned a bank and 31 people. These people included such businessmen as Gennady Timchenko from the Gunvor oil group and the Rotenberg brothers (Arkady and Boris who also has Finnish citizenship) who own contracting companies worth billions. There were also some politicians on the list and also Bank Rossiya. (Yuhas, 2014)

2. Economic sanctions

2.1 International economic sanctions in general

International sanctions mean the limitation or suspension of trade or economic cooperation as well as transport and communication links or the establishment of diplomatic relations with a specific country or specific groups. The purpose of the sanctions is to, in addition with other foreign policy actions, influence another state's or groups policies or actions which are regarded as a threat to international peace and security. Such activities may be, for example, dissemination of weapons of mass destruction, international terrorism or widespread human rights violations. Different sanctions can be, for example, import and export restrictions, financial sanctions and travel restrictions. Sanctions targeted to designated individuals and entities, or specific economic sectors in considered to be more efficient to opposed policies or those who are responsible of the activities, while the negative impact on the civilian population remains minimal. (Ministry for Foreign Affairs of Finland, 2016)

Sanctions can be targeted to, for example, the government of a specified country or to the people who support their actions, but they can also target specific groups, which are not necessarily linked to a particular country. They may also limit the availability of certain products, materials or technologies which are used in the activity being targeted. (Ministry for Foreign Affairs of Finland, 2016)

2.2 Restrictive sanctions issued by the European Union

The situation in Ukraine has been monitored closely by the European Union. The European Council thinks that the annexation of Crimea is illegal and since March 2014, the EU has adopted sanctions against the Russian Federation. These sanctions include; cancelling, EU-Russia summits, asset freezes and visa bans to individuals and companies, banning investments in and prohibiting imports from and exports to Crimea and Sevastopol. Gas was exempted from these sanctions because many of the countries in the European Union rely heavily on Russian gas supplies. (European Parliament, 2015)

In March 2014 an extraordinary meeting was held by the EU Foreign Ministers to discuss the situation in Ukraine. The Foreign Affairs Council condemned "the clear violation of Ukraine's sovereignty and territorial integrity by acts of aggression by the Russian armed forces as well as the authorization given by the Federation Council of Russia on 1 March for the use of the Russian armed forces on the territory of Ukraine." The EU and its' member states belonging to the G8 group also decided to suspend their participation the preparations of the G8 summit which was to be held in Sochi in June 2014. It was also noted by the council that if Russia does not take actions to calm down the situation, the EU would make a decision on the consequences of the bilateral relations between the EU and Russia. These kind of measures may include visa issues and the suspension of negotiations on the new agreement of bilateral negotiations. (European Council, 2014)

Shortly after the meeting the EU organized another extraordinary meeting, where Heads of State and Government discussed the situation in Ukraine and agreed on actions to be taken. Discussion were also held with the Prime Minister of Ukraine, Arseniy Yatsenyuk. In mid-March the EU Foreign Affairs Council approved the restrictive measures which were discussed by the Heads of State and Government on 6th of March. These measures were directed against 21 officials, and the persons and entities associated with them for their involvement in actions threatening the territorial integrity, sovereignty and the independence of Ukraine. At the end of March, the European Council discussed the crisis and started to consider further sanctions. Following the annexation of Crimea and Sevastopol to the Russian Federation, 12 Russian and Crimean officials were added to visa ban and asset freeze list by the EU leaders. In addition, the Council canceled a planned EU-Russia Summit and noted that the member states do not organize regular bilateral summits with Russia. They also urged that an agreement would be made to send OSCE (Organization for Security and Co-operation in Europe) observers to Ukraine as soon as possible. In parallel, the EU leaders and Ukraine's acting Prime Minister, Arseniy Yatsenuk, signed the political provisions of an Association Agreement. (European Council, 2014)

In mid-February 2014 more sanctions were imposed on persons who were responsible for the misuse of state resources in Ukraine. Four of the new person's assets were frozen and they were assigned to the visa ban. EU ministers also encouraged the Ukrainian government to organize a free and fair presidential elections in May. (European Council, 2014). Presidential elections were held in Ukraine on 25th of May. Businessman and

oligarch Petro Poroshenko beat the former Prime Minister Yulia Tymoshenko in the election, receiving over 54% of the vote. (MTV News, 2014)

At the end of June 2014 the Council adopted measures to implement the EU's policy which stated that the illegal annexation of Crimea would not be recognized and goods originating from Crimea or Sevastopol may not be imported unless a certificate of origin has been granted by the Ukrainian authorities. EU leaders stated that there would be more restrictive measures if Russia and the separatists did not take concrete steps by the end of June:

- Agreement on verification mechanism which would be used to monitor the respect of the cease-fire and effective border control by the OSCE
- Three border checkpoints would be returned to the Ukrainian authorities
- The release of all hostages, including OSCE observers
- The launch of negotiations based on the peace plan by President Poroshenko.

EU leaders also signed the Association Agreements with the Republic of Moldova and Georgia. The signature process with Ukraine was also completed. (European Council, 2014)

In July 2014 the Council held a special meeting where the EU leaders underlined their support for a peaceful solution of the crisis and were regretful that the separatists and Russia did not take action to fulfill the required actions that were set at the end of June. The council agreed that Russia would face six new restrictive measures:

- The Council agreed to set a new list of entities and persons, including from the Russian Federation, which support either materially or financially actions against Ukraine. In addition, possible measures were examined against entities or individuals who actively provided financial or material support to Russian policymakers who were responsible for the annexation of Crimea or the destabilization of Eastern-Ukraine.
- The EIB (European Investment Bank) would suspend the signing of new financing operations in the Russian Federation.
- The adaptation of a similar position would be coordinated by the member states with the European Bank for Reconstruction and Development.

- The Commission would re-evaluate the EU's bilateral and regional cooperation programs with the Russian Federation and possibly suspend their implementation.

The Union did not recognize the annexation of Crimea and Sevastopol to the Russian Federation, and in accordance with that concept, the European Council requested proposals to be presented by the Commission and EEAS (European External Action Service) for additional measures:

- on limitation of investments in Crime and Sevastopol,
- and international financial institution to abstain from financing projects, which either directly or indirectly recognize the annexation. (European Council, 2014)

On 17th of July 2014 Malaysian Airlines flight MH17, en route to Kuala Lumpur from Amsterdam, was traveling through Eastern-Ukraine airspace when it went missing from the radar. It crashed near the town of Hrabove killing 283 passengers and 15 crew members. An investigation was made by a Dutch Safety board which suggested that a Russian-made warhead was launched from a pro-Russian held part of Eastern-Ukraine and that caused the crash. (BBC News, 2015)

On 22th of July 2014, a meeting was held by EU's Foreign Affairs Council to discuss the downing of flight MH17 and the circumstances in Ukraine along with sanctions against Russia. The Council urged the separatist groups of immediate, complete and safe access to the crash site. It also supported the call for a transparent and independent investigation carried by the OSCE and the UNSC. (European Council, 2014).

The Council also asked to speed up the measures, concerning the sanctions, agreed earlier in July. These reinforced sanctions were approved at the end of July. At the end of August, Ukraine's President Petro Poroshenko attended to a special meeting held by the European Council and told the EU leaders about the situation in Ukraine. The Council approved significant sanctions against Russia in July and in August it was ready to execute more actions in light of the then recent events in the crisis area. They requested that these new sanctions would be ready to be adopted within a week. These new strengthened sanctions were approved in mid-September. They included restrictions on Russia's access to EU capital markets. European companies and nationals could not provide loans to five major Russian state-owned banks and the same restrictions were

applied also to three major Russian defence companies and three energy companies. Travel ban and an asset freeze was issued to 24 new persons bringing the total number of person's subject to sanctions to 119. 23 entities remained under asset freeze. At the end of November, the list contained 132 persons and 28 entities. (European Council, 2014)

In January 2015 the Council decided to extend the individual restrictive measures, concerning the persons and entities mentioned above, until 2015. In addition, the Council called for on the proposal for a new list of names, which would be decided by the Foreign Affairs Council in February. The addition of new names in the list was unanimously approved in mid-March. 19 new persons and 9 entities, who had contributed on actions against the territorial integrity of Ukraine, were added on the list, bringing the total number of persons up to 151 and the number of entities up to 37. Throughout the year the economic sanctions were continued. At the end of March 2016 the Council continued the travel ban and asset freeze until 15th of September 2016. The list consisted 146 people and 37 companies who had continued threatening or undermining the sovereignty, territorial integrity and the independence of Ukraine. Three people were removed from the list because they had deceased. (European Council, 2016)

On 17th of June 2016 the Council continued the restrictive measures until 23rd of June 2017. Measures applied to EU individuals and EU companies operating in the European Union. They covered to the territory of Crimea and Sevastopol. The sanctions included the following prohibitions:

- products imported from Crimea or Sevastopol in the EU;
- investments in Crimea or Sevastopol: EU-based companies or Europeans can not buy real estate or entities in Crimea, finance Crimean companies or supply related services;
- tourism services in Sevastopol or Crimea, especially European cruise ships can not enter the ports in the Crimean peninsula except in case of emergency;
- exports of certain technology and goods to Crimean enterprises or for use in the telecommunications, energy and transport sectors or if they are related to the production, exploration and prospection of gas, mineral and oil resources. Brokering, engineering, technical assistance or construction services must not be provided either if they are related to infrastructure in these sectors. (European Council, 2016)

2.3 Russia's counter sanctions against the European Union

The trade relationship between the EU and the Russia Federation has been strong since the signing of the Partnership and Cooperation Agreement back in 1997. It regulates the economic and political relations between the two parties. They have defined the relationship as “a strategic partnership”, in which mutual cooperation is used to promote stability and prosperity in Europe and beyond. The EU is Russia's biggest trading partner and Russia, in turn, is the third largest trading partner with the EU. The trade volume decreased in 2014, because of the recession in the Russian economy and because of the conflict in Ukraine which was the reason for EU sanctions and Russian countermeasures. (European Parliament, 2015). In 2013 the EU imported goods worth 207€bn from Russia, while exports from Russia totalled 119,5€bn. In 2014 the imports were 182.4€bn and exports 103.2€bn. Last year (2015) the imports were 135.7€bn and exports 73.9€bn. (European Commission, 2016). The statistics show that the trade relations have suffered due to the sanctions.

In August 2014 an edict was signed by Russian President Vladimir Putin, which prohibited the import of raw materials, agricultural products and food from the countries that had imposed sanctions against Russian companies or individuals. A list was adopted describing the products which were to be banned. It included various products from different groups: dairy and meat, fruit and vegetables. The countries which fell under the prohibition were the United States, the European Union, Canada, Australia and Norway. 73% of the banned product came from the European Union. The prohibition was set for one year. In the summer of 2015 Russia extended the counter sanctions for one year and announced that the embargo would also include food products originating from Iceland, Montenegro, Albania and Liechtenstein. (European Parliament, 2015)

2.3.1 Effects of the counter-sanctions in the European Union

The estimated impact of the European Union's goods exports varies from 12.1% up to 14.5%. It is hard to separate the effects of the mutual sanctions issued by both parties

because of the weakened Russian demand on markets. There has also been two negative blows on the Russian economy in addition with the restrictions: the drop in oil and raw material prices and a steep weakening in the rouble's value. The effects of the counter sanctions on EU economy is pretty complicated. The high level of economic integration of EU countries cause indirect effects on the trade disruption, in addition to the sanctions. Some of the exports lost to Russia have found alternative markets elsewhere. (European Parliament, 2015)

There are two ways how the exports to Russia have been affected. Firstly, the depreciation of the rouble, caused by the flight of capital from Russia has weakened the purchasing power of Russia. Secondly, the EU has banned certain products, such as technology which is designed to search for oil and gas deposits. In retaliation, Russia imposed import embargoes for example on meat. The suppliers of these products in the EU will inevitably face some losses. Because the economic crisis and sanctions in Russia relate to each other, the exports, which are not affected by the sanctions, also face deteriorating prospects because of the weakening economic situation and spill-over effects. On a larger scale, one can think that the sanctions and the decline in oil prices (although the decline of oil price started before the sanctions) are linked to each other and this creates many benefits for the EU economy such as lower production costs and increased purchasing power. (European Parliament, 2015)

Agricultural and food exports account 7% of the total EU exports of goods. Around 9% of the exports go to Russia, making it second in the list of most important destinations for EU agricultural products, after the USA. Agri-food exports to Russia from the EU were worth €11.3 billion in 2013. Total of about 4.2% of EU agri-food exports, worth approximately €5.1 billion, were hurt because of the Russian counter-sanctions. The sanctions do not include several vital sub-sectors, such as spirits and wines, pasta, olive oil, beverages, cereals, and a many other products. EU agri-food exports to Russia fell by 43% between August 2014 and July 2015. (European Parliament, 2015).

3. Finnish foreign trade

3.1 History of Finnish foreign trade

Foreign trade is vital for a small open market economy such as Finland. In 2015, Germany was the most important trade partner. The exports to Russia have been declining and also the value of imports have been declining because of the fall in energy prices. During the globalization of businesses, increasing share of foreign trade is intra-company trade. The importance of foreign trade in services has grown in recent years. Throughout the years, foreign trade has been very significant to Finland. After the recession in the early 1990s the total of exports quadrupled by the year 2008. In 2009, the exports of goods and services fell by fifth. (Kangasniemi, 2015)

Trade relations between Finland and Russia/the Soviet Union stem from the ages of the Grand Duchy. Although Finland was connected to Russia, it was a Grand Duchy and the kingdom of Russia was separated in the border by the customs. The differences got even deeper when Finland acquired its own currency. Trade exchange between the two neighbors increased especially when Finland was connected to Russia via railroad. At the time, Russian industry was, in some areas, only slightly developed and the capital, at the time, was close to the Finnish border, making it easy for Finland to acquire market places for their products in the neighboring country. In the late 1800s, Finland was one of the most economically developed areas in the Russian Empire. (Androsova, 2002)

Because of the First World War, the Baltic Sea was almost completely closed for Finnish merchant ships. Finland was an autonomous part of Russia making it virtually the only possible trade partner. During the Second World War, trade with Russia was at a standstill. But generally, except the time between the world wars, trade with Russia has been a vital part of Finnish foreign trade, also during the difficult political – or even geopolitical – times. However, it is important to bear in mind that mutual economic exchange depends not only on the political situation, but also in the trade of financial resources and possibilities. Being close neighbors, contribute to trade and tourism, but the purchasing power is the key. (Liikanen, 2015)

Since the beginning of the 1900s until far into the 1970s, Finland's most important export market was the United Kingdom, except during the war years. It has been estimated that the United Kingdom was almost the size of the Russian Empire, in terms of total production, in the eve of the First World War in 1913. From a Finnish perspective, the United Kingdom was easier to reach via the sea routes than the vast Russian Empire. Finnish foreign trade was, and is, behind the seas and most of the trade is carried on ships. The rise of the United Kingdom alongside, and past, Russia as Finland's most important export market during the second half of the 1800s is also an important part of Finland's deeper integration into the world economy. At the same time, it is also an indication of how the Finnish economy benefited from the relatively liberal attitude that the Russian Empire pointed to the Grand Duchy of Finland, including trade policy. There are many more examples, not least the fact that the Bank of Finland was founded 49 years before the current Russian Central Bank and that the Finnish markka was tied to the silver standard 150 years ago. (Liikanen, 2015)

Because of the First World War, Finnish foreign trade was forced to seek new markets. Political factors also affected the trade between Finland and Russia/the Soviet Union very unfavorably. The Soviet Union had very poor relations to the outside world for many years and only the very essential products were purchased abroad. This was also partly an ideological choice. Self-sufficiency in almost all was held in virtue and in that kind of situation, the trade has no chance to succeed. The Second World War changed the situation completely also in the Finnish foreign trade. Great Britain's position as the most important export destination remained, but Russia came alongside. However, it is also good to remember how difficult the situation in Finland was right after the war. A large part of the production capacity was destroyed or was handed over to the Soviet Union. Finland had a shortage of almost everything, even food and in this situation, imports from the Soviet Union were very important. In addition to food, Finland could also purchase fuel which was needed for the industry. Some of this Finnish imports returned to the Soviet Union in the form of reparations. (Liikanen, 2015)

When the political and economic situation stabilized in the 1950s, Finland was trading busy to both east and west. The trade between the Western Europe and the United States were conducted on a commercial basis, while the trade with the Soviet Union was defined by politics. Still the trade, at least in general, followed the principle of comparative

advantage. Since the 1960s, the Soviet Union produced a lot of energy products for export and Finland purchased them gladly. The period after the Second World War was fairly balanced in the Finnish foreign trade and the economic relation between Finland and the Soviet Union for a long time. Finnish exports were diverse and the imports from the Soviet Union, Sweden, Germany and the United Kingdom were almost as important. But the interaction of geopolitical and economic factors changed the situation in the 1970s. Two oil crisis and the explosive situation in the Middle East lifted crude oil prices sky high. In the bilateral trade between Finland and the Soviet Union, the rise of oil prices meant that increased value of imports from the Soviet Union corresponded to increase in exports from Finland over the eastern border. In the early years of the 1980s, the Soviet Union's share of Finnish exports rose to over 25%. (Liikanen, 2015)

In 1989, the Soviet Union was the largest destination for Finnish exports and this accounted for 15% of exports of goods. When the Soviet Union fell apart in 1991, it collapsed the Finnish trade to the east and deepened the recession which began from the financial and banking sector. The decline in exports was particularly evident in weakening demand of vehicles, machinery and equipment, and wood- and paper industry products. However, in spite of the deep recession, the trade balance improved and turned into a surplus. Although the value of exports fell from the peak of 1989 and the bottom of 1991 by 15%, imports fell by 24% at the same time, which indicates that the Finnish domestic factors had great importance in causing the recession. The value of exports and the trade surplus began to grow rapidly towards the end of 1991 – already one and a half years before the gross domestic product was reversed. The Finnish markka was devalued in November 1991 and allowed to float in September 1992, which improved cost competitiveness. The trade balance improved relative to every major trading partners except Russia. (Bank of Finland, 2015)

Finland's trade surplus grew throughout the 1990s peaking at the turn of the millennium. The surplus growth was caused by the overall rapid development of world trade which helped the Finnish export industries, especially in the wood and paper industry, as well as the electrical engineering and electronics. In the wake of globalization, the trade surplus grew, viewed by country, on a very wide range. Finnish export companies managed to create products which were widely demanded and capable of conquering new geographical market areas. At the turn of the millennium, electrical engineering and electronic industry had passed the forest industry as the largest export sector and its

products accounted for about a third of total export value. The year 2000 was the peak year and electrical equipment and computers were exported by a value of €20 billion. At the same time the trade balance posted a surplus of €1.4 billion monthly. (Bank of Finland, 2015)

The trade surplus began to shrink in the early 2000s, although it was positive until the end of the decade. The burst of the international IT bubble slowed down the growth of the world trade and stopped the world conquest of Finnish electronics industry, measured by the value of good exports. The exports of computers and electrical appliances remained strong for a long time, but the purchasing-power-adjusted export value never again reached larger than the level it was at the turn of the millennium. Production of Finnish ICT (information and communications technology) industry and export volumes still continued to grow, but at the same time the prices of ICT products began to fall at a fast pace, so that the euro-denominated export earnings remained subdued. After a brief recession, world market prices of many raw materials went on a sharp rise which continued until the outbreak of the international financial crisis. The price increase in raw materials was particularly evident in the import of Russian crude oil and began to shrink the trade surplus. In addition to the prices of raw materials, underlying factors of the import growth in Finland included the China phenomenon and the strengthening of domestic demand. The importance of China grew towards the end of the decade, and, especially, imports increased heavily since the middle of the decade, which pushed the trade balance between Finland and China to a deficit. At the same time the trade balance between Finland and Germany turned into a deficit. About third of the Finnish import industry consists of intermediate products for the export industry, so the fast growth of imports also reflected increasing export demand. (Bank of Finland, 2015)

The financial crisis, stemming from global financial markets, quickly spread to the real economy and caused a worldwide recession, which caused the collapse of the value of Finland's foreign trade. Both imports and exports shrank by more than a third, from the top of the trend to the bottom. Compared to earlier recessions, the collapse of foreign trade was significantly wider and deeper. The value of Finland's foreign trade declined in all major categories of goods and trading partners. The value of electrical engineering and electronics exports fell by half and it has not recovered like the other categories of goods. The reasons of this collapse lay in the Finnish mobile phone sector which had its

own difficulties. These difficulties were not directly related to the financial crisis itself, although they took place during the same period. Traditionally, Finnish exports have consisted largely of investment goods and intermediate industrial products, so export growth has been highly dependent on the economic situation of other countries. After the collapse of consumer-oriented mobile phone exports, the share of investment goods and the dependence of exports on economic situation of other countries have continued to increase. Shortly after the crisis the trade balance fell into deficit, when the prices of raw materials rose again. Finland became a net importer of computers and electrical appliances. (Bank of Finland, 2015)

Import and export value has decreased again after a temporary recovery following the financial crisis. The decreased value of foreign trade has been reflected in a wide range of goods and continued to decline, compared to earlier episodes of decline, exceptionally long time. After the financial crisis, industrial production, associated with high technology, declined permanently and the average productivity of Finnish work deteriorated, which meant that the cost competitiveness of the economy remained weak. The high costs, compared to rivaling countries, have continued for a long time and have been eroding the market shares of Finnish export enterprises. Despite the difficulties in the forest industry, the value of exports of forest products has remained relatively stable in recent years. Although the share of wood and paper products in Finnish exports has fallen by half since 1989 to about 20%, the forest industry has maintained its position as a cornerstone of Finnish exports, along with machinery and metal industries. Since 2014, the downhill of Finnish imports and exports got even steeper because of the collapse in global market prices of raw materials. However, the trade balance surplus grew especially because of the decline in crude oil price. The decline in Finnish exports has also affected by a historically large maintenance shutdown at the Porvoo oil refinery at the spring of 2015, which cut the exports of refined oil products by about €1 billion. The economic importance of the production of refined oil products is, however, lower than one could conclude from the export share, because the domestic value added share of refined oil products is rather small compared to other export sectors. (Bank of Finland, 2015)

Although the exports have declined, its value has increased because of the increased exports of transportation equipment to Germany. Behind of this growth are the cruise ships produced in the Turku shipyard in 2014 and 2015 and the increase in car

production at the Uusikaupunki car factory. The exports to Russia have been declining heavily. Back in 2008, Russia was Finland's biggest trading partner, but its share began to shrink in 2013 because of the fall in raw material prices and Russia's economic difficulties. Also the share of exports to the United Kingdom and Sweden have declined. Germany has become the most significant trading partner. Also the importance of the Netherlands, the United States, Estonia and China has grown in recent years. (Bank of Finland, 2015)

3.2 The effects of the EU imposed sanctions on Finnish exports to Russia

The second phase sanctions imposed by the European Union has significantly wider and more direct effects than the first stage sanctions that primarily constrained the actions of the oligarchs. They restrict the export of certain products to Russia directly and make it harder for Russian companies to receive funding. The outlook of Finnish technology industry companies also fell because of these sanctions. In Russia, the sanctions, in addition with the decline of oil prices, slow down strategic investments. The sanctions remain to have a debilitating effect on the confidence of consumers and businesses. Fortunately, export of the product groups which fell under the sanctions from Finland to Russia is low. Its value, between 2011 and 2013 was around €30 million per year. This was 0,55% of Finland's exports to Russia. This can also be an overestimation, because the sanctions are defined according to the intended use of the products, so that certain items will also include permissible exports. Because of this, some of the products can be exported to Russia. The most significant products for Finland on the EU sanction list have been pipes, pumps and tools used in the oil and gas sectors as well as miscellaneous machinery or parts of them. In addition, they include the so-called multi-purpose products suitable for military use. (Berg-Andersson, Kotilainen, 2016)

Export of the product groups, which are subject to EU sanctions, decreased to €14 million in 2015, which is roughly half of what it was in 2012. While at the same time, the whole Finnish exports to Russia fell by 44% from 2012 to 2015, export of the goods on the sanction list have not fallen that much more. However, the constraints, imposed by the US and the EU, on the financial sector, makes it difficult to export number of other products to Russia. It is difficult to assess the magnitude of negative impact on exports occurring through financial channels. (Berg-Andersson, Kotilainen, 2016)

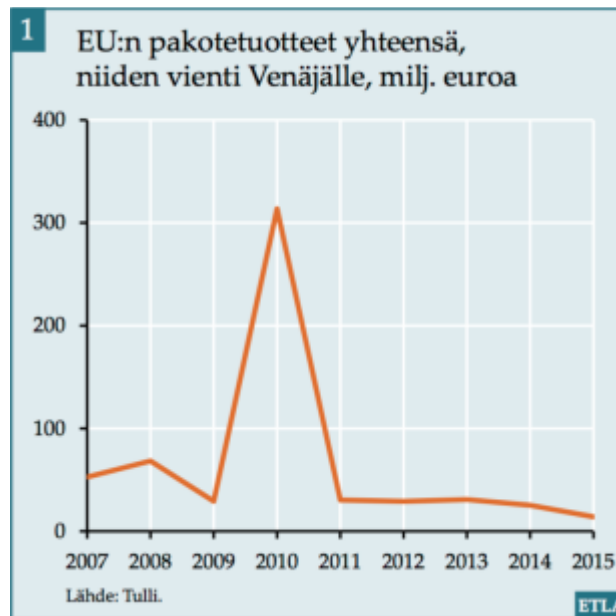


Figure 1. EU sanctioned products in total, exports to Russia, in million euros. Finnish Customs, 2016

3.2.1 The effects of the Russian imposed sanctions on Finnish exports to Russia

The sanctions imposed by Russia to food exports have significantly higher importance on Finnish-Russian exports than the sanctions imposed by the European Union. Between 2011 and 2013, exports to Russia of the product groups subject to these sanctions amounted to an average of €270 million per year, which was 5% of Finland's total exports to Russia. Most important products for Finland, that are on Russia's sanction list are; milk, meat and fish, as well as products made from them. In addition, there are product groups which include for example vegetables and fruits. Finnish dairy and meat export industries are the ones that have been suffering the most. Last year the share of dairy products and cheese of the Finnish food industry was only 0.9%, when in 2014 the share was 53% and in 2013 60%. The largest single company among the suffering has been Valio. Farmers have suffered in the form of low milk and meat producer prices. (Berg-Andersson, Kotilainen, 2016)

In 2015, the export value of the product groups that are under the sanctions was €2,9 million, which was 0,1% of all the Finnish exports to Russia. Exports of the foods belonging to these groups practically ended, while at the same time the decline in total

exports between 2012 and 2015 was 44%. The sanctions have had a significant impact on the food industry exports country breakdown. Before the crisis in Ukraine, Russia's share of Finnish food exports was about one-third. In 2015 Russia's share was only 8,6%. Direct impacts of Russia's counter-sanctions on Finnish economy can be estimated roughly by relating exports decline in total output. The share of food exports, under the sanctions, in 2013 was 5,3% of the whole food exports to Russia while the share of the all the exports was 0.5%. The computational effect of these exports to Finnish GDP is 0.15%. One has to bear in mind that the food exports would have declined also because of the decline in oil price and because of the devaluation of the ruble so the direct effect of the sanctions is around 0.1%. This effect is reduced over time because some of the foodstuff can be exported with supported and discounted prices to e.g. Asia. However, the export processing rate is falling. (Berg-Andersson, Kotilainen, 2016)

The increased supply creates pressure to reduce the price of foodstuff in Finland, but on the other hand the weakened profitability of food companies creates pressure to raise prices. The competitive situation resolves the net effect. The sanctions issued by Russia also has a negative impact on the Russian economy. Price of food products will rise which raises the inflation. This tends to raise the level of interest rates in Russia and thereby weaken economic growth and the purchasing power of citizens. On the other hand, import restrictions strengthen the position of production taking place in Russia and its attractiveness as an investment. (Berg-Andersson, Kotilainen, 2016)

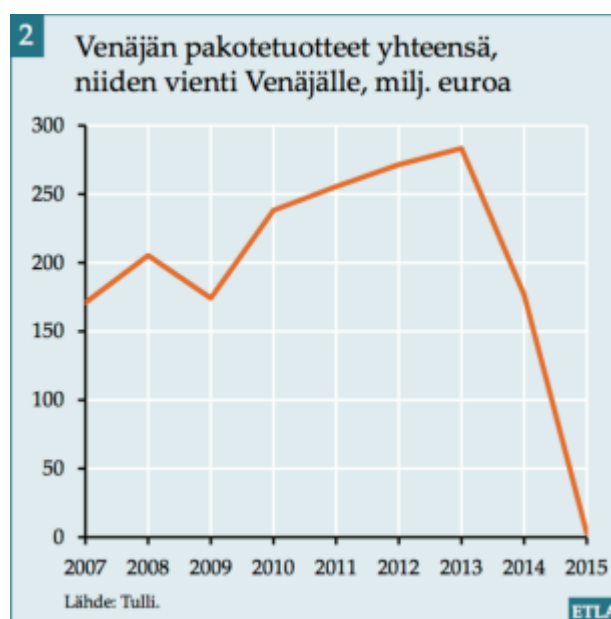


Figure 2. Russian sanctioned products in total, exports to Russia, in million euros. Finnish Customs, 2016

3.2.2 The effects of the Russian imposed sanctions on other countries

Finland, of course, is not the only one that has suffered because of the sanctions and it is important to look at the effects on other countries as well.

Food exports from Estonia, Lithuania, Finland, Norway and Poland have been effected the most because of Russia's food ban between 2013-2014. When looking at the absolute value of sanctioned trade with Russia, Germany, Norway, Poland, Lithuania and Denmark are the countries that have hit the hardest. Still, products banned by Russia did not exceed 1% of the total exports of these countries, except in Lithuania, which relatively minimizes their overall export losses. (Stratfor, 2015)

CHANGE IN EXPORTS TO RUSSIA BETWEEN 2013 AND 2014



Source: ITC Trademap

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Figure 3. Change in exports to Russia between 2013 and 2014.

Data from 2015 indicates that Estonia, Lithuania and Latvia, which have been relying on Russian market for their agricultural exports, have been suffering the most. In the first half of 2015, Estonia's exports, mainly in the agricultural sector, fell by 41% compared to the same period in 2014, before the Russian sanctions. Lithuania's exports fell by 38% and Latvia's exports by 24% over the same period and in the same sector. The trade between other countries in the European Union and Russia also fell in the first half of 2015. From January to May 2015, German trade with Russia fell by 43%, but this was mainly because of declining trade in industrial good. Agricultural trade from Germany to Russia only accounted for a small part of total bilateral trade. Because of the Russian food ban, Italy also suffered losses totaling €1,2 billion. Yet again, food accounts only a small part of Italy's trade with Russia. (Stratfor, 2015)

Politically, the imposed sanctions have not changed EU's policy towards Russia. Countries, especially the Baltic states, asked the European Commission for compensation for economic losses because of the agricultural ban. Nevertheless, restrictions have not made the European Union more accommodating and the bloc unanimously extended the sanctions against Russia until the end of 2015 (and until the end of June 2017 after that). Because of this, the President of Russia, Vladimir Putin, signed the extension of the food ban until the end of August 2016. Russia also has been tracking down the smuggling of banned products, because it apparently diluted the severity of Russia's ban. The EU then started to export more products to Kazakhstan and Belarus, which are in a customs union with Russia. These products were then re-exported to Russia. In early 2015, Russia closed this loophole, but the re-exporters falsified the illegal shipments countries of origin. Thousands of kilograms of illegally imported food was then destroyed by Rosselkhoznadzor, which is Russia's Federal Service for Veterinary and Phytosanitary surveillance, and Alexander Tkachyov, Russia's agricultural minister, spoke of criminalizing food smuggling into the country. Still, the agricultural ban has not convinced the Western world to ease their sanctions against Russia. (Stratfor, 2015)

The Russian economic sanctions have been more effective on countries outside of the European Union, but are pro-West. In August 6th of 2015, Russia added several countries outside the EU, but which had joined the sanctions against Russia, to the ban, including Ukraine. This decision was to be introduced if Ukraine would go forward with the trade component of the EU Association Agreement. Russia has applied the restriction list to

Moldova since 2014, but selectively. Several companies have had exemptions because they are in pro-Russian regions such as Gagauzia and Transdniestria. (Stratfor, 2015)

Because of these restrictions have been applied selectively, political negotiations has been prompted in the region. For example, in Moldova, the government have eased the restrictions on transit of Russian military personnel to Transdniestria. Russia has also started a political dialogue with Georgia and threatened to add it to the agricultural ban list in August 2015, but after discussion between Georgian and Russian officials, Georgia was excluded from the list. (Stratfor, 2015)

Russia's counter-sanctions have not been effective in forcing the European Union or the United States to ease their sanctions against Russia. It is more like that the situation in eastern Ukraine will influence the sanctions rather than Russia's economic measures. Be that as it may, Russia has had a political dialogue with Moldova and Georgia and threatened them with economic restrictions and has brought up the possibility of adding Ukraine to the import ban list. Russia's counter-sanctions are likely to be just one element of its strategy against West. (Stratfor, 2015)

4. Conclusions

What kind of effects have the economic sanctions had on Finnish economy and exports? If we look purely at statistics, we can see that the export industry has suffered the most. Producers have had to find for alternative markets in order to cope with their losses and, for example, Valio, the company that has suffered the most, have had to lay off around 100 employees in 2014 (Valio, 2014), 182 in 2015 (Kiviranta, 2015) and announced that they are going to close their dairy in Tampere. (Mansikka, 2016) It is clear that this all is because of the Russian counter-sanctions.

Finnish workshops, for example Sampo -Rosenlew, have been forced to find new buyers from Central Europe and emerging markets. The crisis in Ukraine has not yet affected Sampo-Rosenlew's North African operations, but the workshops are afraid that the effects will come later. (Niittymaa, 2015) Sampo-Rosenlew is a Finnish company which manufactures agricultural machinery, for example, combine harvesters and forest harvesters. They sold 35% of the company to Indian company called Mahindra & Mahindra in 2016 and are now looking for new markets for combine harvesters from Asia, Middle East and Africa. (Meritähti, 2016)

It is evident that Finnish exports have suffered because of the sanctions, but the main reason is in the steep drop in oil price and the weakening of the ruble. They have reduced the purchasing power of Russian businesses and consumers. Finland has lots of knowledge, skill and innovations, but because of the poor economic situation, it is hard to find finance. There is also the eternal problem that Finns do not know how to market themselves thus that is changing as we speak, when the younger generations are taking over managerial positions.

It is hard to estimate the future of the Finnish economy because the crisis in eastern Ukraine is still ongoing. The sanctions are tied to the Minsk peace agreement and as long as Russia does not honor it, the sanctions will stay. (Kähkönen, 2015). Russia started a military intervention in Syria at the fall of 2015 and after that the focus of the world has shifted. Mainstream news are no longer reporting as much about the situation in Ukraine that they did roughly a year ago. Also the European refugee crisis has taken over more and more column space. Because of this, European countries are struggling how to cope with the massive group of people coming from the Middle East and North

Africa and might not be so interested on the Ukrainian crisis. The refugee crisis is in their doorsteps and it is fair to say that it apparently interests more. Also the terrorist attacks in Central Europe and the fight against the Islamic State seems to concern more.

It is difficult to say what Russia's motives are in Syria, but it is speculated that they want to speed up the refugee crisis in Europe thus making European economies suffer and maybe loosen their sanctions against Russia. It is also concerning that the US-led coalition backs and supplies the rebels of the Free Syrian Army when Russia helps the Syrian government against the rebels. One of the reasons that Russia is in Syria might be the decline in the crude oil price. Russia wants the oil price to be around \$45-\$50 per barrel and if it drops under that, the Russian economy will suffer. Today, the crude oil price is around \$42 per barrel. (Oil-price.net, 2016). Russian economy started to rise at the turn of the millennium and Russian people have grown accustomed to better quality of life. If the Russian government lets its economy to ruins, the people might start to consider changes in the leadership. Especially rich Russian oligarchs might even try to overthrow Putin, but up to this point, the Russian President has managed to keep all the strings in his hand, although he rules with an iron fist. There is a saying in Finland that Russians are happy as long as there is enough cabbage and potatoes, but because of the upswing that Russians experienced after the millennium, it is hard to say if it is still true. We have to keep in mind that all of this is speculative and only reflects the author's thoughts of the current situation.

Another thing that we need to take in consideration is the situation in the United Kingdom. After the vote in June 2016, the UK decided to withdraw from the European Union. If Brexit is to happen, it would have an impact to Finnish exports as well, because last year Britain was the sixth largest destination for Finnish exports. The value of Finnish exports to Britain was €2,8 billion, and its total share in total exports was 5,2%. Although Britain is not the most important destination of Finnish exports, the possible Brexit might cut back the economic growth in the European Union and the United Kingdom. (Rossi, 2016)

After the vote in the United Kingdom, there has been speculation that Finland should vote for a so called "Fixit" and leave the European Union thus abandoning the sanctions and returning to business as usual. This kind of speculation has fortunately been only marginal. It might give a boost to the Finnish economy, but in the long run the disadvantages would be higher than the benefits.

The best thing that could happen would be that Russia and Western world could find a solution in eastern Ukraine as well as Syria. In the long run, Russia's reserve funds will come to an end, because of the military interventions they are currently involved in. Peace in eastern Ukraine and in Syria would balance the economies and ease the pressure that the European countries are currently experiencing. The European Union is not able to stand the current situation for long and because of the Brexit, more and more countries could become irritated and start to arrange their leave from the EU. This could trigger a global recession that no one has never seen before. As history shows, when there is a recession, usually a war follows. But the game has changed since the Second World War. Nowadays there is no conventional wars between two or more states. It is rather a "hybrid-warfare" which does not necessarily even happen on the borders of participants, but in another country, such as Syria or Ukraine.

It is interesting to see what happens in Finland in the coming years. There is no doubt that we are part of the West, but Finland is still in a same kind of state that it has been since the 1950s. The strategy for Finland has been to be kind of a middleman between the east and the west, trying not to irritate either side. Even though Finland is pretty much a western country, it should try to keep good relations to Russia so it could overcome its difficulties in its economy. One solution to the problem could be that Finland could organize a similar event that they held in 1975, which dealt with, for example, security issues in Europe and cooperation in security. This kind of conference could help the situation in Europe and bring balance.

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