

Eskelinen, Heikki

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## When Intentions Meet Realities: Typology of Contacts across the Finnish-Russian Border

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# **When Intentions Meet Realities: Typology of Contacts across the Finnish-Russian Border**

Heikki Eskelinen & Dmitri Zimine<sup>1</sup>

*Paper for the 41<sup>st</sup> ERSA Conference, Zagreb 2001*

Abstract: Cross-border cooperation can be defined as conscious joint activity pursued by local and regional governments with more or less strong support from civil society, and facilitated and constrained by central governments and international organisations. Since about 1990, this phenomenon has also been witnessed across the former Iron Curtain, simultaneously with various forms of cross-border economic transactions and informal contacts. Yet in most cases, cross-border regionalisation has remained rather weak, and it has not met the early ambitious targets of creating a new borderless Europe.

Given the background outlined above, the present paper attempts to clarify the interplay of official cooperation and other cross-border contacts: whether they have developed in accordance - or at least in touch - with each other. For this purpose, a typology of cross-border contacts is created by dividing them into formal v. informal and private profit-oriented (economic) v. public benefit-oriented (political) ones. The basic assertion of the paper is that the lack of regionalisation phenomena across divisive borders may result from that these different forms of cross-border interaction develop independently from each other.

The empirical analysis focusses on one border town in the Russian North-West. It attempts to clarify in detail the mechanisms through which various forms of cross-border contacts have influenced developments in it, modifying the transition process at a local level. The observed dynamics of cross-border contacts leads to a conclusion that the four types of cross-border contacts have displayed very different trends in the 1990s, and they have failed to create joint dynamics because of the obstacles imposed by the existing institutional realities on both sides of the border. On this basis, it is asked whether the strengthened informal cross-border networks may well soon begin to exert pressure upon formal public and private institutions with the aim to further develop the formal framework facilitating cross-order contacts.

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<sup>1</sup>Karelian Institute & Department of Geography, University of Joensuu, P.O. Box 111, FIN-80101 Joensuu, Finland, and St. Petersburg Centre for Russian Studies, St. Petersburg, respectively. Email: Heikki.Eskelinen@joensuu.fi; zimine@hotmail.com

## 1. Context and aims

Cross-border cooperation can be defined as conscious joint activity pursued by local and regional governments with more or less strong support from civil society, and facilitated and constrained by central governments and international organisations. According to Blatter & Clement (2000), cross-border cooperation in Europe has been increasingly conditioned by continental integration, and it has been in general more stable, institutionalised and formal than the respective activity in North America. In this comparative setting, the basic dilemma of the European approach is obvious; one can ask whether a policy intervention can set into motion or at least contribute to network-type more permanent cross-border contacts, which will create their own dynamics of development.

There was a considerable amount of official cooperation between Finland and the USSR in the Soviet era. Yet cross-border cooperation in the above mentioned sense was not allowed. Central governments set very strict limits to contacts, and units of government below the national level as well as professional and citizens' organisations and interest groups did not have any space of action outside the official cooperative framework (cf. Anderson 2000). In brief, cross-border interaction was almost by definition limited to state-directed cooperation, and the existence of informal interaction and its development towards a variety of cooperative practices was excluded.

Since around 1990, a number of cross-border cooperative activities have been pursued at the Finnish-Russian border. After the period of interregnum in the early 1990s, they have been streamlined towards a European cross-border cooperation regime. This can be seen, for instance, in that the political rationale of these activities has been primarily argued on the grounds of newly-defined security threats, increasingly under the European Union's Northern Dimension initiative. In addition, a major share of funding for cross-border projects has come from European sources, and the Euregio concept has been taken into use as the keyword in developing embryonic forms of cross-border governance.

As far as the impacts and experiences of cooperation are concerned, the observations are approximately in line with what has been found in several other cases along the East/West divide in Europe. Cross-border regionalisation phenomena have remained weak, and impacts of cross-border exchanges have not transformed the economic roles of the two neighbouring regions. This is most concretely seen in the Finnish-Russian case in the fact that since direct contacts across the border were allowed, the regions on the two sides have rather lost their positions in their respective national contexts and the welfare gap between them has widened (Alanen & Eskelinen 2000). Cross-border cooperation has, to a major extent, remained an elite activity, its legal competences are still minimal, and the early ambitious visions have been modified towards the harsh realities of the peripheral partners. However, nation-level and European political proposals and funding programmes have provided basic backing and resources for cooperative efforts, and some partners (e.g., regional councils in eastern Finland and the government of the Karelian Republic in the Russian Federation) have clearly proceeded in their contacts. This can be seen in the fact that they are currently establishing more institutionalised frameworks for their interaction (e.g., Cronberg 2000, Eskelinen 2000).

The present paper derives from the above outlined background. Firstly, it attempts to clarify the mechanisms through which various forms of cross-border interaction and cooperation have influenced developments in the Russian border region, modifying the transition process at the local level (cf. Kosonen & Oinas 1999). On this basis, the main purpose of the paper is to assess whether official cooperation and other types of cross-border contacts have developed in accordance - or at least in touch - with each other. The basic assertion of the paper is that their segregation may actually be an important reason for the lack of regionalisation processes across a border. The empirical investigation focusses on one border locality, the town (district) of Sortavala in the Karelian Republic in the Russian North-West.

Not surprisingly, most studies of cross-border cooperation focus on political, legal and administrative aspects of the phenomenon, utilising well-documented material on various initiatives and programmes. As a separate line of research, economic studies survey cross-border flows and the role of different borders as barriers to economic interaction and internationalisation. The present paper attempts to avoid this divide: the purpose is to survey local developments in detail so that the impacts of different forms of cross-border interaction and their interdependencies - or lack of them - can be revealed and discussed in a sound theory-laden framework.

Developments in Sortavala and related cross-border interaction are analysed in detail in Chapters 2 and 3. Chapter 4 draws some conclusions, and evaluates their policy relevance.

## **2. The case: Sortavala**

Sortavala was founded as an outpost of the Swedish expansion on the north-western corner of the Lake Ladoga in the 17<sup>th</sup> century. Since the second half of the 19<sup>th</sup> century, this local market town developed a distinctive role as the cultural and educational centre in this frontier region. In the 1920s and 1930s, it was a stronghold of the newly independent Finland's specific borderlands policies for strengthening national identity and unification in the region where Russian cultural and economic influences had been important before the closing of the border after the October revolution (see, e.g. Paasi 1996).

As a result of the WW2, the town of Sortavala and its surrounding region was annexed into the Soviet Union. The entire population left for Finland, and the region was resettled. In the current administrative structure of the Karelian Republic (and the Russian Federation), the Sortavala district borders Finland, although its centre (the historical town of Sortavala with 21 thousand inhabitants) lies approximately 60 kilometres from the border. - The population of Sortavala district is currently approximately 36 thousand; that is, somewhat smaller than the population of the same territory during the Finnish era in the late 1930s.

Until the final years of the Soviet Union, Sortavala was closed to foreigners, and also Soviet citizens needed a special permission for visiting there. The cross-border railway link via the Finnish border village of Niirala to Sortavala and further was used for cargo traffic, but there was no checkpoint for passengers. The industrial base of the town de-

veloped on the basis which had been established in the Finnish times, that is, mechanical wood-processing: its Furniture-and-Skies Combine (FSC) employed several thousand people and was famous in the USSR, because the skies it produced were widely distributed across the country. Sortavala was also a producer of various construction materials, such as marble and stones. Local agriculture was focussed on cattle-breeding, fur-farming and fishing (in the Ladoga Lake). The agricultural sector was mostly oriented to the local and regional markets.

Naturally, the process of economic and political transition has conditioned developments in Sortavala, as anywhere in the former Soviet Union, since the late 1980s. Yet there are also peculiarities which are contingent to local circumstances, of which the proximity of the border is the most distinctive factor. In the following, socio-economic and political changes in Sortavala since the beginning of the 1990s are surveyed in some detail for purposes of compiling a coherent locality-specific account of the transition process, and especially of the role of the border-related phenomena in it.

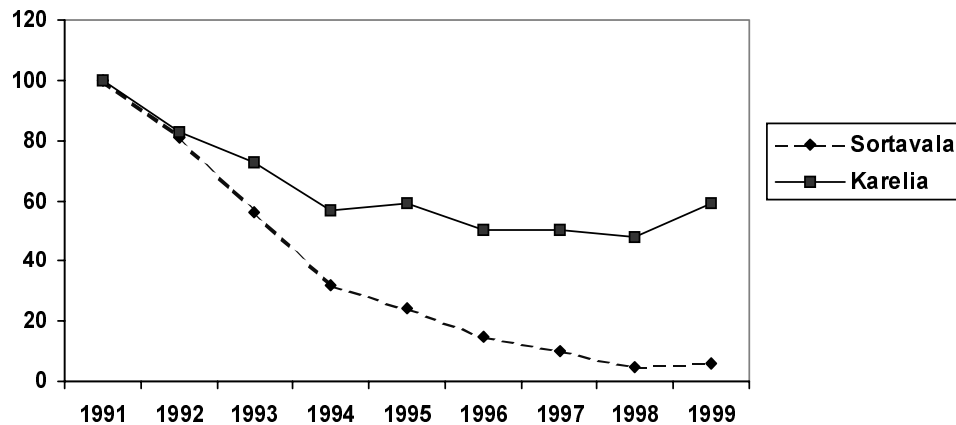
## 2.1. Economic and social trends

**Industry:** Since the early 1990s, when the transition process began, the situation has dramatically worsened. The FSC went bankrupt and has been split into several smaller enterprises which have also experienced financial difficulties. The demand for construction materials in Russia has shrunk and, as a result, Sortavala's stone-quarries have substantially scaled down their production activity. Consequently, the rate of decline in industrial output has been deepest among the municipalities in the Karelian Republic: not less than 94 per cent in 1991-99 (41 per cent in the Republic on the average), and even the upturn in 1999 remained negligible, around one per cent whereas it was more than 20 per cent in the Republic (see Fig. 1).<sup>2</sup> One of the very few moderately successful industrial enterprises in Sortavala has been a ferrous-metals plant in the decayed mill community of Vartsila next to the border-crossing point, producing various low-value metal goods (such as nails, grids, etc.) primarily for export. Another more or less successful industrial branch has been export-oriented timber-logging. Two companies have been particularly active in this field: the Finnish-Russian joint venture Ladenso and AO Karlis-Vartsila. Overall, the industry has become largely export-oriented: according to Revaikin (2001), the annual value of Sortavala's export is approximately 9-10 million US\$, which actually exceeds the value of local industrial production.

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<sup>2</sup>However, it should be noted that there are different estimates of the Sortavala industrial output. The Federal Statistical Committee states that in 1999 it was RUR 87, while the municipal administration estimates it at RUR 148 million (Kareikomstat, 2000 and Morozova, 2001). This can be explained by the fact that the Federal Committee accounts for only the output of large and medium-sized companies, while the local estimate account for small enterprises as well. For economic trends in the Karelian Republic as a whole see [http://www.hkkk.fi/~vbi/karelia\\_en.pdf](http://www.hkkk.fi/~vbi/karelia_en.pdf)

Figure 1. Dynamics of real industrial output, 1991=100



Source: Karelkomstat (2000).

**Agriculture:** The trend has been roughly similar to that in industry, although decline in output has been less significant – 50 per cent. Large collective agricultural enterprises - with the exception of one collective farm and a large poultry farm - have either gone bankrupt or disintegrated. Their place has partially been occupied by more than eighty smaller private farms, but these have not been able to wholly compensate for the loss of production (see Table 1). Commercial fur-farming and fishing activities have ceased entirely. After this profound transformation of the agricultural sector, a large number of Sortavala citizens are involved in informal part-time farming.

Table 1. Dynamics of output of agricultural goods in 1991-1998, % change

	Sortavala		Karelian Republic as a whole	
	Individual farms	Collective farms	Individual farms	Collective farms
Potatoes		-83.8	+5.8	-71.9
Vegetables	+77.7	-90.0	+81.9	-44.4
Livestock	+16.1	-52.8	-2.6	-62.2

Source: calculated on the basis of Karelkomstat (1999), 56-75.

**Investment and corporate finance:** In 1991-97 investments in real assets declined by two-thirds, and further in just three years from 1997 to 1999 by 87 per cent. In particular, Sortavala has not been successful in attracting foreign investment (see Ch. 3).

**Employment:** Economic decline has severely affected employment in the municipality. In the 1990s, the total number of jobs declined by 36 per cent, which was more than the Karelian average (29 per cent). The decline was particularly sharp in the sectors where private ownership dominated: industry, agriculture and trade. At the same time the number of jobs in some sectors dominated by public ownership has grown, for instance in education, culture, administration and municipal housing services (see Table 2). As a

result, in 1999 approximately 60 per cent of the total employment was in the public sector.

Table 2. Employment dynamics in Sortavala in 1991-1998, % change

	Sortavala	Karelian Republic
Privately-owned sectors:		
Industry	-69.9	-41.9
Agriculture	-64.9	-55.3
Construction	-55.0	-71.8
Trade and catering	-64.4	-39.3
Publicly-owned sectors:		
Municipal housing services	+14.3	+2.1
Health & social welfare	-6.3	-1.2
Education	+61.9	-10.6
Culture & arts	+13.2	-16.0
Science, R&D	-	-67.4
Transport	-35.4	-18.1
Communications	-2.6	-3.5
Other	+27.3	+45.2
Total	-36.4	-29.4

Source: calculated on the basis of Karelkomstat (1999), 134-136.

However, the creation of public-sector jobs has not compensated for the overall decline in employment. Sortavala has faced the problem of unemployment, which has been particularly acute in small settlements closer to the borderline such as Vartsila, Kaalamo and Ruskeala. In 1999 official unemployment rate was 7.6 per cent, but in reality this figure accounted for just a fraction of unemployed persons as they do not have strong incentives to register; the real rate of unemployment could be as high as 30 per cent. At the same time, there is demand for workers of particular professions, but these are not available on the Sortavala labour market. In addition, enterprises offer so small wages that the unemployed are not interested in them. Short-term contracts have become the dominant form of labour relations, as long-term employment is not convenient for employers who in this case have to guarantee paid vacations and social payments to workers. Low wages force people to find secondary employment, and as a result, many people are involved in informal economic activities such as subsistence farming and cross-border small-scale trade. Approximately 20 per cent of Sortavala's residents have simultaneously two or more jobs.

As a whole, the restructuring of the local economy during the 1990s has led to the situation in which the Sortavala economy consists of the following four sectors:

1. A small group of industrial enterprises oriented towards foreign markets (ferrous metals, timber and timber products),
2. An even smaller group of industrial enterprises oriented towards domestic markets (foodstuffs and construction materials, mainly for road construction),
3. A sizeable informal sector comprising major part of agriculture, tourism and trade, as well as cross-border activities.

4. The public sector providing about 60 per cent of the total number of officially-registered jobs.

Obviously, the above outlined economic basis has implications for the finances of the local public sector. The Sortavala district has become heavily dependent upon financial transfers from the Republican Government. More than a half of the total municipal incomes was provided in the form of financial transfers from the Republic in the late 1990s, and this inflow to Sortavala has been in per capita terms two times higher than that to Karelian districts on the average. The revenue base of the Sortavala budget has been systematically reduced by the steady economic decline and by changes in tax-sharing arrangements between the Republic and the district (see Table 3). This problem has been exacerbated by a poor financial discipline of federal authorities and the Sortavala administration. In particular, the Federal Government has quite often failed to provide Sortavala's military units (e.g. a detachment of border guards) with adequate funding for paying municipal services (such as heating, electricity, water supply and sewage). As a result, the total debt of the military to the local budget was RUR 11 million as of 20 August 1999. Likewise, the impoverished population of Sortavala could not fully pay for municipal services; the accumulated debt reached RUR 6 million in mid-1999 (Durkin 1999). Furthermore, the local tax base has been weakened by the fact that several companies conducting business in Sortavala do not pay taxes to the municipality because they are registered in other jurisdictions.

Table 3. Incomes of the Sortavala municipal budget

	1996	1997	1998	1999
Total municipal budgetary incomes, RUR thousand	70337	59605	59775	100864
Municipal revenues, RUR thousand	28501	36881	30342	45528
Financial assistance from the Republican budget	41836	22724	29433	55326
Share of VAT allocated to the municipal budget, %	20	20	10	N/A
Share of corporate profit tax allocated to the municipality, %	22	22	5	N/A

Sources: Druzhinin (2001), Grigorieva (1999).

Under these circumstances, the only choice for the local administration has been to abolish a major part of planned investments in social infrastructure and in maintenance of municipal facilities, as well as to systematically cut real wages of public-sector employees. As a result, the quality and scope of municipal services have dramatically deteriorated, although the number of workers in some public sector branches has not declined due to the transfer of public services from combines to the local administration. Wages in the public sector have declined to as low as 70 US\$ per month on average (Kareikomstat 1999).

**Population dynamics and social problems:** Faced with the economic crisis and deterioration of vital municipal services, the population of Sortavala has begun to decline (in 1990-98 by 6 per cent), and it is also rapidly ageing as young people go to study in larg-



er cities and prefer not to return. At the same time, the rise of several acute social problems has been apparent. Reportedly, about a quarter of young residents of Sortavala has already tried narcotics (Grigorieva 1999). A related problem has been the decline in public health. In 1999 the incidence of illnesses in Sortavala was in per capita terms two times higher than the Karelian average, which is respectively two times higher than the Russian average. In particular, the incidence of hepatitis, tuberculosis and sexually transmitted diseases have increased at a fast pace. (Ladoga 23 April 1999). The latter illnesses are obviously linked with prostitution; there are reportedly about 200 prostitutes in Sortavala (Ruchiev 2000). Finally, the problem of crime has plagued Sortavala. The number of registered crimes per capita in the district is more than two times higher than in Karelia as a whole. Many crimes are related to illegal drug trafficking and trade, and about one third of them are committed in the border settlement of Vartsila, where the crime rate is particularly high (Grigorieva 1999b). Amongst causes of this situation many observers name, firstly, the economic crisis, low wages and unemployment; secondly, the absence of cultural facilities for the youth; and, thirdly, influence of the border, i.e. the demand for prostitutes created by Finnish visitors.<sup>3</sup>

## 2.2. Development initiatives and policies

To turn the dismal development trends, the municipal administration commissioned in 2000 a study aimed at creating a development programme for Sortavala. This study was conducted by researchers of the Karelian Science Centre from Petrozavodsk. The programme was approved in late 2000.<sup>4</sup> It proposes several directions for Sortavala's socio-economic development, namely:

Social development:

- Development of social infrastructure;
- Development of the local community;
- Marketing of the territory.

Rational and effective usage of local resources:

- Utilisation of mineral resources;
- Development of the timber industry;
- Development of agriculture.

Tourism development:

- Improvement in state regulation of tourism;
- Development of tourist infrastructure;
- Tourism development on the Valaam Islands.

Utilisation of Sortavala's border location:

- Wholesale trade transit development;
- Retail trade transit development;
- Integration into international division of labour.

The programme looks comprehensive, but it lacks a focus – there is no prioritisation of the objectives. Apparently, the programme presents a list (not a compromise) of the

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<sup>3</sup>Interview with Tatiana Morozova, Joensuu, 11 May, 2001.

<sup>4</sup>Full text of the programme is available at <http://www.citystrategy.leontief.ru/?it=3af14c84dd630>, see also <http://sortavala.karelia.ru/pipl/gov/progr/index.html>

interests of the four above-mentioned main economic sectors. It mixes popular proposals, such as "to increase equality in the distribution of personal incomes," with a number of business development ideas, which are not necessarily consistent with each other. The ideology of the programme seems to dwell upon the following two premises:

1. It is necessary to foster a wide partnership between public authorities, private businesses and the population at large; everybody should have the opportunity to participate in formulation of development objectives; and
2. Public authorities should guide private business actors, because the latter do not know exactly how to improve their business operations.

The first postulate is a tribute to the ideology of civil participation, which has also been actively promoted by various foreign grant-makers operating in Russia. Their objective is to develop a civil society in Russia, but it is not clear whether this participatory approach is feasible, and how it could be applied in creating local economic development programmes.

The second postulate derives from the assumption the local business community is not aware of potential business ideas in Sortavala. No evidence is given to support this case, and in fact, rather the opposite seems to be true: new ideas are not realised due to the fact that there are serious obstacles to them, and it is not only the Federation or the Republic which are to be blamed for the situation. Thus, the local administration should rather focus on improving public policies in order to make the local business climate more supportive.

Irrespective of these queries, the development programme can be regarded as a significant step, as a first effort by the Sortavala administration to look beyond its routine day-to-day concerns and formulate a strategy for coping with the decline of district.

For present purposes, it is noteworthy that the programme includes a special part concerning cross-border co-operation. This part proposes three initiatives:

1. To set up a large wholesale trading company which would assist Russian producers (not only Karelian ones) in exporting their production to the Nordic countries. This company would provide logistic, consulting, packaging, marketing and customs clearance services.
2. To create one or two large retail shopping centres (first of all in Vartsila) targeting at Finnish visitors, in order to turn Sortavala into a major centre of legal shopping tourism.
3. To stimulate cross-border trade in services, when foreign companies subcontract some operations (for instance, sewing of clothes) to firms in Sortavala. It is even proposed to set up a special free customs zone for this purpose.

Clearly, these ideas are not at all novel, and entrepreneurs on both sides of the border are well aware of them. Further development of these ventures is hampered not by a lack of understanding of existing business opportunities on the part of private actors, but because public authorities in the Karelian Republic have created unbearable conditions for doing business, even for local companies-insiders. The growing interest to this field on the part of district authorities may in reality signal two things: either the Sortavala district administration sincerely wants to help the informal cross-border traders legalise and stimulate their business, or it desires to become an entrepreneur itself and to mo-

nopolise cross-border trade at the expense of the informal sector. It is not clear yet which approach will be applied.

Apart from the programme, the Government of the Karelian Republic has formulated its own practical agenda for Sortavala's development. First of all, the Government strives to find, register, and tax all business entities in Sortavala (i.e. those which do business in the district, but have not paid taxes there). Secondly, the Government has actively promoted the construction of a new large timber-processing plant by the Finnish-Swedish Stora-Enso Company, though a realisation of this idea looks uncertain. Thirdly, the Government has assisted in the modernisation of a milk plant in Sortavala. Fourthly, it has intended to build a hospital for drug addicts. Lastly, the Karelian Government has promised to provide funding for tourist infrastructure development on Valaam.

### **2.3. Political situation: main actors and their interests**

Not surprisingly, the profound transformation of Sortavala's position on the external border of the Russian Federation, and its overall decay during the transition period, have raised new issues on the local political agenda. Currently, there are two principal axes of political struggle in Sortavala: (1) that amongst business ventures for gaining control over natural resources (timber), and (2) that between businesses and the district administration over tax payments.

The Government of the Karelian Republic has the undivided power in the allocation of forest logging quotas, and thus competition of the first type (over forest resources) is a matter of lobbying skills of Sortavala's timber companies in the Karelian Government. In general, the Finnish-Russian Ladseno Company has been a winner in such competition, although the company itself has seen its operations in Russia as an uphill struggle. Thanks to its strong informal links with the Government, Ladseno has managed to increase its logging quotas at the expense of other enterprises, including the district administration itself. Thus, in 1999 Ladseno's quota was increased to 46 per cent of the total (116 thousand cubic meters), while the share of the Sortavala municipal administration and administrations of all settlements within the territory of the Sortavala district was cut to 25 per cent (Morozova 2001). So, apparently, in Sortavala some companies have been more powerful than the district administration, which acts not only as a public authority, but also as a competitor striving to get control over available natural resources. There is also another aspect of this competition: it is the competition between timber-logging and wood-processing enterprises. Despite the rhetoric of the Karelian Government about stimulating the wood-processing industry, in practice the Government has promoted the logging industry through allocation of logging quotas. This has contributed to the fact that overwhelming part of timber logged in Sortavala is exported, while local wood-processing enterprises are forced to buy timber in other regions of Russia (for instance, Vologda and Arkhangelsk). Obviously, Sortavala's timber-logging enterprises (and, perhaps, even the district administration) do not want to see the creation of any new independent wood-processing ventures on this territory – new competitors for forest resources. This is a real obstacle for both economic development and cross-border interaction in the district, and in the Karelian Republic as a whole.

The second struggle – for tax payments – has also been won by companies-insiders. For businesses the rationale is simple: (1) to minimise tax liabilities and (2) to guarantee an acceptable level of social order (i.e. nobody wants social unrest). The task to minimise tax payments has been achieved effortlessly by companies-insiders, which know how to smoothly manage their relationships with local and central public authorities.<sup>5</sup> Only companies-outsiders – not included in the complex web of long-term relationships with local decision-makers (e.g. Solidinvest Company from St. Petersburg) – have faced the problem of high taxes. Such outsiders are regarded as thick cows, which must be milked to death, unless they create an alliance with a local insider.<sup>6</sup> In general, this is precisely the reason why foreign management and marketing techniques often fail in Russia. Foreign companies entering the country regard local insiders as competitors. In reality, they are not competitors, but just elements of business infrastructure which can be effectively used to facilitate business operations in Russia. This is what happens also in Sortavala: only insiders can survive.

However, having their tax liability *de facto* minimised, Sortavala's insiders well understand that the tax money they pay is not sufficient to secure a necessary degree of social order allowing the companies to do business. That is why companies-insiders are obliged to make voluntary contributions to support some public services. Examples of this are abundant. For instance, Ladenso has recently assisted the Federal Employment Service in arranging community works for the unemployed. Another example: the agricultural enterprise Oskar (in Kaalamo) regularly assists local schools and other public services (see <http://kalevala.gov.karelia.ru/gov/Karelia/669/35.html>). As a result, it is possible to note the emergence of a new social contract *a-la-Russe* amongst businesses, local public authorities and Sortavala's population. Businesses guarantee minimal tax payments and additional informal contributions to secure an acceptable level of social order. The administration does not enforce all legal requirements upon businesses and the population at large, thus allowing everybody to make some money and not pay too much in taxes. The population accepts this state of affairs and does not destabilise this balance by actions of civil disobedience.

Amongst other major political actors in Sortavala it is possible to name the Orthodox Church, October Railways Company and Customs Committee. The political interests of the Orthodox Church stem from the desire to preserve its complete control over the Valaam Islands, which also means control over financial flows created by tourists and pilgrims visiting the monastery in their thousands. The district administration opposes this situation, as it wants to set up a special historical zone on Valaam and charge money from visitors - this idea is also mentioned in the development programme. However, the administration has not yet been successful in the realisation of this plan, because the Church is much more influential. The Federal Government, the Orthodox Church and the Karelian Government have recently concluded a special agreement con-

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<sup>5</sup>It should be clearly pointed out that if insiders would not resort to dubious tax-avoidance practices (and bribes), their business activities would be impossible, because taxes are just too high and legal requirements are too confusing. That is why the usage of some semi-legal methods of adaptation can be regarded as a positive phenomenon allowing economic life to continue.

<sup>6</sup>In the mid-1990s this company acquired a wood-processing plant in Sortavala. However, when new managers from St. Petersburg arrived to the plant they found that its equipment was urgently transferred to another enterprise. The only choice they had was to abandon this venture and leave Sortavala.

taining an investment programme for Valaam. According to this programme, the Islands will receive total investment of RUR 500 million (\$ 17.8 million), which equals to eight Sortavala's annual municipal budgets (Lugovskoy 1999). The October Railways Company has been very important for Sortavala as a large employer and the main transport firm. The problem has been that it is more profitable for the company to transport export goods (for instance, timber), because in this case tariffs are 2-3 times higher than tariffs for domestic transportation. As a result, Sortavala's producers of non-exportable goods (for instance, construction materials) have faced problems with getting carriages to transport their production. Both the Karelian Government and the district administration have asked the company to do something about this situation, but the company has been able to ignore such requests, because it is subordinated only to the Federal Government.

Finally, there is a contradiction related to the Federal Customs Committee. The task of the Committee is to collect as much customs duties as possible. This objective contradicts the interests of Sortavala's business community which would like to see a relaxation of customs controls, as well as a lowering of duties. However, neither businesses nor the authorities of Sortavala or the Karelian Republic possess any means to change this situation: customs duties are a very important source of federal revenues. Another problem has been related to the operation of the border crossing point in Vartsila. The district administration has many times asked the Customs Committee to extend opening hours of this point, but until spring 2001 without any success (see, for example [http://www.tos.ru/mt/plain/discuss/disc\\_6002.htm](http://www.tos.ru/mt/plain/discuss/disc_6002.htm)).

### **3. Cross-border interaction**

Chapter 2 made obvious that various repercussions of cross-border interaction are clearly discernible in the local peculiarities of the transition process in Sortavala. For instance, the price of roundwood has tended to rise as a result of foreign competition and contributed to the almost complete deindustrialisation process of the local economy, and at the same time, shuttle-trading activities have provided opportunities to earn one's living in the burgeoning informal economy. In addition, various foreign and border-related influences in the form of tourism, cooperation projects, part-time dwellers, criminal activity and humanitarian aid have become permanent features in Sortavala, in a border town on the lower side of a welfare gap.

For the present purposes, the most important conclusion from the account of developments in Sortavala in the 1990s is the fact that it cannot be regarded as a success story. The local economy is undergoing a more severe crisis than the Karelian Republic on the average, and the existence of serious social problems is indisputable. This is in a sharp contrast to the expectations in the early stages of the Russian transition when the location of Sortavala next to the border was seen to provide it with relatively favourable preconditions for development both by means of private sector investments and public sector cooperation initiatives. - In the following, a brief account of these phenomena is given.

### **3.1. Foreign economic activity**

The opening up of the Russian border from the late 1980s onwards was not based on a carefully planned strategy, but rather it resulted from a gradual liberalisation process. The opportunity was received with enthusiasm in Finland. Immediately after access to Sortavala was allowed, a wave of nostalgia tourism emerged: elderly Finnish people went to see their place of origin. This cross-border flow contributed to the development of Finnish-owned economic activity especially in retail trade, catering and hotel sectors in Sortavala. By 1994, 25 joint ventures or foreign (read: Finnish)-owned firms were established in Sortavala, but since then this activity has been on a decline (Eskelinen et al. 1997). By 1999 only 6 firms with a foreign ownership remained in Sortavala., and the total value of accumulated foreign investment in the municipality was only 200 thousand US\$ as of 1 January 2001. Neither has Sortavala received investment from domestic sources. This lack of investments has led to a cumulative decline: the production of exportable goods cannot be increased, and at the same time, the town is not able to establish a role as a point of entry for imported goods as, for instance, Vyborg has been able to do due to its more advantageous location on the Helsinki-St. Petersburg route. In sum, the poor state of the local economy, and the legacy of frustration caused by the exit of the early investors, has become an effective constraint to formal cross-border business interaction.

No statistical data on trade flows between the Sortavala district and its neighbouring regions in Finland are available. Yet it is evident that eastern Finland is the final destination of a major share of Sortavala's exports, which primarily consists of timber. Overall, these trade cross-border flows are asymmetrical: from the point of view of the Karelian Republic and also of the Sortavala district, Finland is an important market, although the composition of exports is not seen satisfactory. From the Finnish point of view, the Karelian Republic has not been a relevant market. This is illustrated by, for instance, the fact that the share of the whole Russian Federation is about 4 per cent of the exports of the country's easternmost province, North Karelia.

### **3.2. Official cooperation**

Cross-border contacts between local administrative units, which were pioneered during the early enthusiasm of cross-border activity, have been followed by more official forms of cooperation between public organizations at various levels, including a number of projects aiming at transfer of expertise, investments, and so on (see, e.g., Eskelinen 2000). Sortavala has not been sidestepped in this cross-border activity. Rather, its past role as a Finnish town has emphasised its position as a potential partner and target.

After the collapse of the Soviet Union, the Finnish and Russian governments agreed on their mutual relations in 1992. The treaty on the so-called neighbouring region cooperation was part of this arrangement, and in practice it led to the establishment of a state-funded Finnish assistance programme targeted at Russia. Its measures have been aimed at reducing various soft security risks and supporting the economic transition process. As part of this cooperation, a number of individual projects have been implemented also in the Sortavala district. For instance, the road connection from the town to the border-crossing point in Värtsilä was reconstructed in the early 1990s.

Since 1995, Finland's membership in the EU has had an impact on the practices and funding of cross-border cooperation. It is not any more a bilateral issue, but part of a much wider whole, transnational cooperation in northern Europe. Also, EU policy instruments, including the INTERREG and the Tacis, have been implemented in the Finnish-Russian border region. The INTERREG funding is for the EU (that is, Finnish) territory, which has naturally curtailed its impact on the Sortavala district; typical projects have included mapping of cross-border tourist routes and upgrading knowledge on the Russian society among actors involved in cross-border interaction. The Tacis (Technical Assistance Programme for the Commonwealth of Independent States) is a very wide programme, and it has included a specific Cross-Border Cooperation (CBC) element since 1996. Whatever its possible achievements elsewhere, its flagship project in Sortavala has turned out to be a disaster, and this is probably not only due to coincidental factors. The project aiming at a modernisation of the town's water supply and sewerage system was originally prepared as a joint project between Sortavala and the nearest town, Joensuu, in Finland. After several years' struggling with administrative and technical requirements of the Tacis since the funding of 2 MEURO in 1996, the project was cancelled in 2000. Other Tacis-funded projects which have been implemented at least partly in Sortavala include Development of Nature Trail Network in the Jänisjoki and Ladoga Region and Karelia Park Development and Management.

Overall, one of the key problems in implementing various assistance and cooperation projects has been caused by the incompatibility of the partners' competences. The neighbouring towns of Sortavala and Joensuu did not succeed in fitting their joint project into the complicated Tacis framework. Another incompatibility problem is apparent in several other cases due to the fact that most of the foreign-funded projects have been organised not directly by the Sortavala administration, but through the Government of the Karelian Republic, or even with an involvement of the Russian Federation. The Government of the Karelian Republic has its own Ministry for International Affairs which controls foreign relations between the districts and foreign public authorities. According to the current state of affairs, only the Government has the legal power to conclude international agreements. That is why foreign authorities and international organisations prefer to deal directly with the Government, while district-level administrations play a subordinate role. Of course, any Karelian district is happy to receive financial and technical assistance in any form. However, if it could determine which projects should be implemented first, the list of realised projects would be different from the one decided by the Republican Government - and the foreign financiers.

In any case, the Government of the Karelian Republic has been very active in developing foreign relationships. It has concluded bilateral co-operation agreements with a number of local authorities in Finland and Sweden, participated in the Barents Euro-Arctic Regional co-operation (BEAR), initiated Tacis-funded projects, and played an important role in the agreement on the Euregio Karelia jointly with the regional councils of the INTERREG Karelia IIA region in Finland. The context and aims of this Euregio have been defined in the following way:

"At the internal borders of the European Union, cohesion and economic integration are on the agenda. At the EU external borders the goals are less ambitious, such as easing concrete border crossings, increasing the economic, social and cultural cooperation and the removal of problems related to environment, economy, security, or attitudes attached to the border. The goal of Euregio Karelia is through a gradual process to cre-

ate common decision-making arenas and common funding possibilities for development work in order to achieve these goals" (Cronberg & Sljaminec 1999, 27).

It is interesting to note that this policy agenda emphasises the role institutions and clearly admits that regionalisation across Russian borders cannot at all fulfil those criteria which are used when discussing the formation of functional regions in the EU. This represents a different line of thinking in comparison to the early 1990s, when the spontaneous, market-driven dynamics of cross-border interaction was thought to be a much more important driving force than it has turned out to be. Also, the European connection is emphasised in two meanings: symbolically, by designating this embryonic form of cross-border policy framework a Euregio and, in somewhat more concrete terms, by stressing its links to the development of political and economic relations between the European Union and the Russian Federation.

From Sortavala's point of view, the Euregio Karelia could in principle represent the acutely-needed institutional framework for establishing more permanent working relationships across the border. However, it is not even mentioned in the development programme of the town (see Ch. 2).

For the present purposes, it has to be emphasised that the above-mentioned cross-border initiatives of public authorities have not been based on the demand from private profit-making enterprises. The private sector has not been ready to exert political pressure upon public authorities with the aim to stimulate cross-border links. On the Russian side of the border, instability caused by the transition and local competition between logging and wood-processing companies did not allow this to happen in the 1990s. In Finland, economic links with peripheries in the Russian North-West - with the exception of roundwood imports - have not been seen important; soft security concerns have clearly outweighed them.

Almost all the cross-border projects which have received support from various cooperation programmes have been of non-commercial nature. They have aimed at providing solutions to the most pressing needs of Sortavala, such as healthcare reform, environmental protection, employment promotion, tourism development, modernisation of water utilities and provision of humanitarian aid. It is fair to say that irrespective of their shortcomings, as a whole they have made a significant positive impact on the situation in Sortavala.

### **3.3. Informal cross-border contacts**

Nonetheless, neither the public-sector initiatives, nor formal business links have been the main essence of cross-border relationships in the case of Sortavala. Informal contacts have become the core of cross-border interaction. Private individuals were quick to understand and reap the opportunities created by the wide gap in personal incomes between the Finnish and Russian sides of the border. Table 4 illustrates the growth of border-crossings.



Table 4. Border crossings (1000) in 1990 (1989)-2000

	Niirala-Värtsilä	Finnish-Russian border: total
1989	n/a	882
1990	75	993
1991	105	1333
1992	149	1299
1993	191	1631
1994	202	2023
1995	442	3714
1996	504	4017
1997	493	4083
1998	630	4570
1999	815	5112
2000	866	5630

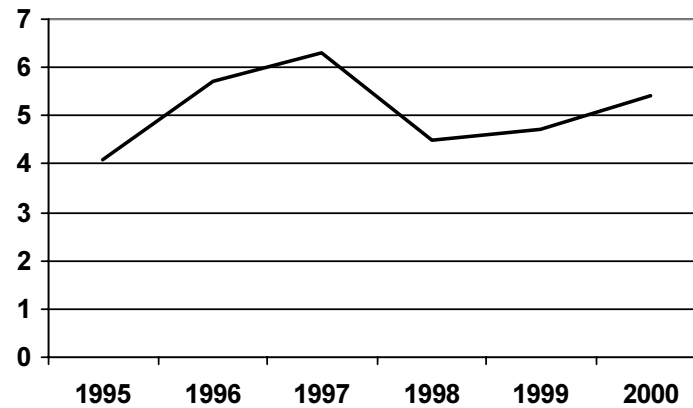
The trend via the Niirala-Vartsila crossing-point has been upwards throughout the 1990s, although the heyday of the lost-Karelia tourism was already a thing of the past before its opening for international traffic in 1994. Currently, the total number of annual border-crossings is approaching one million. The share of the Niirala-Vartsila crossing-point has increased, and accounts for about 15 per cent of the total number at the Finnish-Russian border. Almost all users of the Niirala-Värtsilä crossing-point - approximately 99,5 per cent in 1999 - are Finnish or Russian citizens. The share of Russian citizens has been on an increase, and is currently more than one-third.

The reason for the burgeoning cross-border traffic is local shopping tourism, which used to be primarily from Finland to Russia, but has more recently developed towards a two-way activity. Since the opening of the crossing-point, a variety of typical border-related services have mushroomed in the immediate proximity of the border and along the road to Sortavala. Finns visit to Sortavala to buy cheap Russian petrol, cigarettes, alcohol, and so on, whereas Russians come to eastern Finland to buy goods which are not well available in Russia.

According to estimations in the Sortavala Economic Development Programme, Sortavala's citizens (36 thousand in total) made 90 thousand trips to Finland in 2000, and 250 thousand Finns visited the district in that year, spending about FIM 340 million there. The latter figure (equalling to fourteen annual municipal budgets of Sortavala) is probably somewhat inflated, but any reasonable estimate on the volume of this spending is a three-digit figure, and represents as such a major inflow of cash into the local economy. Surprisingly, this huge amount is not reflected in retail trade statistics; in fact, in 1998-2000 Sortavala's retail turnover per capita was below the average of the Karelian Republic. This fact testifies that the bulk of Finnish money goes to the informal sector, which is the main beneficiary of cross-border contacts. However, it is not known how the informal sector is organised, that is, whether it represents a disorganised community of private individuals and small companies or whether it is a well-organised network with its own hierarchy and distribution of responsibilities. Reports in Karelian press have suggested that the Sortavala informal sector has strong links with St. Petersburg's mafia controlling informal cross-border activities (see, for example, <http://icc.karelia.ru/smi/34.htm>). Likewise, Russian visitors spend considerable amounts

of money in Finland, which is partly reflected in Finnish statistics on duty free sales. Thus, in Joensuu (eastern Finland) the dynamics of duty free sales has closely reflected changes in economic situation in Russia (see Figure 2). The drop in sales in 1998 occurred, obviously, because of the Russian financial crisis.

Figure 2. Dynamics of duty free sales in Joensuu, FIM million



Sources: Statistics Finland and Joensuu municipality ([www.jns.fi](http://www.jns.fi))

In addition to shopping tourism, other forms of informal cross-border interaction have evolved. A number of individual activists and organisations have established cross-border contacts or networks in various spheres of social life. To a major extent, their focus has been on one-way humanitarian aid activities or transfer of expertise at a grassroots-level. For instance, Boichenko & Heikkinen (1999, 350) estimate that "approximately a hundred Finnish political, religious, social, professional and cultural women's unions and informal clubs or networks are involved in charity work in the Karelian Republic."

Migration has also developed into an important cross-border phenomenon. Due to a change in the Finnish policies in the early 1990s, a significant number of ethnic Finns and Ingrians, Russian citizens, has emigrated to Finland. This flow has been supplemented by Russian women marrying Finnish men and also leaving Russia for Finland. As a result, only in the municipality of Joensuu the number of Russian immigrants increased by 68 per cent in 1995-99. It should be noted that there is also a small migration flow in the opposite direction: some Finns move out to live in Russia. These contacts have stimulated cultural integration at a grassroots-level, which can be seen in the spreading of the Finnish language in Sortavala and the Russian language in Eastern Finland.

#### 4. Conclusion: a typology of cross-border contacts

On the basis of the above observations it is possible to identify two classification criteria for the creation of a typology of cross-border contacts. These criteria are (1) the legal basis for such contacts: formal versus informal, and (2) their organisational reason: private profit-oriented (economic) versus public-benefit-oriented (political). Thus, four different types of cross-border contacts can be described (see Table 5)

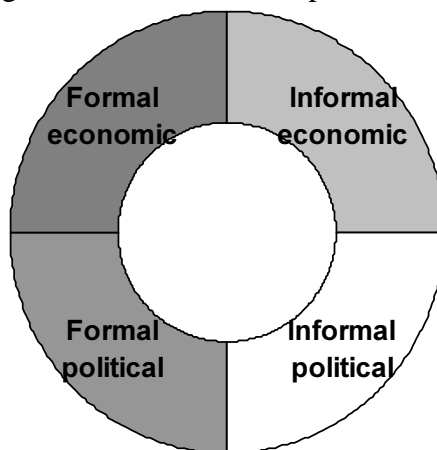
Table 5. Classification of cross-border contacts

	Formal	Informal
Private profit-oriented (economic)	1. Foreign trade and investment	3. Shopping tourism, migration, crime
Public-benefit-oriented (political)	2. Official co-operation agreements, international projects	4. Informal cross-border networks addressing issues of public interest

As it was demonstrated above, contacts of the first type (formal economic) have not evolved much because of external and internal obstacles, although existing potential in this field is significant, especially due to major differences in cost levels. The second-type contacts (formal political) have developed much better, primarily because of the desire on the part of Finland and the EU to secure stability in the Russian North-West, a strategically important region on the Eastern border of the Union. Cross-border projects of this type have included propping up some services of the ailing public sector, but they have not been based upon expressed demand from private economic actors. Informal economic relationships (the third type) represent an obvious success in terms of cross-border interaction, although typical border-related criminal activities have increased as a by-product of this process. Informal cross-border networks of non-economic type have, for their part, been to an important degree been represented by one-way processes, aid and expertise in various forms from Finland to Russia, and migrants to the other direction.

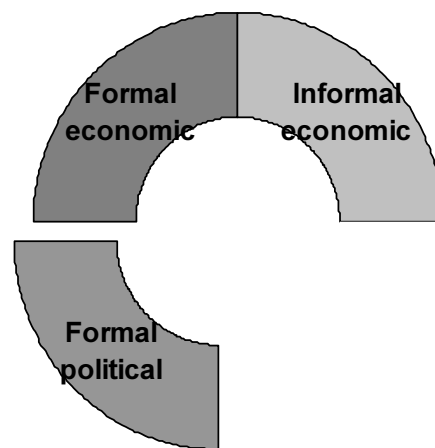
This paper demonstrates that these four types of cross-border contacts have developed almost independently from each other in Sortavala. However this, of course, does not mean that this situation will continue in the future. On the contrary, these types of contacts could have important implications for each other. Thus, formal economic relations may both stimulate and can be stimulated by formal political relations. Likewise, formal and informal economic contacts can mutually support each other. At the same time informal economic links may promote the development of informal political networks pressurising formal political institutions in order to make cross-border regime more acceptable for informal actors. In sum, it is possible to present interdependence between the types of cross-border contacts as a circle (see Figure 3).

Figure 3. Circle of interdependence



Apparently, in the case of Sortavala important interdependencies of this circle are missing or deficient.<sup>7</sup> Firstly, informal economic networks have not developed in the way that they could defend their interests at the political level. Also, there is no link between formal economic and formal political contacts: at present they exist independently and practically ignore each other. Again, this can be explained as a result of the weak development of formal economic contacts which have not yet evolved to a degree when they would defend their interests using political measures. So, at present in Sortavala this circle is not complete (see Figure 4). Informal and formal economic networks are not linked with the official co-operation framework.

Figure 4. Cross-border interaction in Sortavala



Clearly, each element of this circle has its own development dynamics. Thus, the development of formal economic relations will depend on economic situation in Russia and Finland, as well as on global economic trends. The future of formal political contacts will be affected by further evolution of political regimes in the Karelian Republic and the Russian Federation, and in Sortavala, and by changing Finnish and EU interests in such contacts. Informal economic relations will crucially depend upon border crossing formalities: the easier to cross the border, the more developed such contacts. Emergence of informal political relations will likely be conditioned by the dynamics of informal economic contacts. It will be greatly facilitated by the emergence of the new generation of grown-up children of Russian emigrants living in Finland. This generation will constitute a material manifestation of cross-border integration and the creation of a real cross-border community.

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<sup>7</sup>The Finnish-USSR cooperation makes an interesting point of comparison here: the connection between formal political and formal political cooperation was tight, and informal contacts were basically excluded, or at least seen as strictly subordinate to the political framework.

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