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## Distant neighbours. Economic adjustment processes at the Finnish-Russian border

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# **Distant Neighbours.**

## **Economic Adjustment Processes at the Finnish- Russian Border**

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### **Abstract**

For decades, the closed East/West border was an effective barrier for cross-border interaction at a local and regional level. It was reflected, among other things, in production structures and settlement patterns in the border regions. Since around 1990, economic and other forms of cross-border linkages have been possible, and they have raised the issue about adjustment processes, that is, whether regional and local economic actors are able to utilise existing complementarities and create new ones, and how this will make itself felt in the roles of the border regions in the international division of labour.

The paper investigates regional adjustment processes in the case of the Finnish-Russian border, which is characterised by one of the deepest socio-economic and cultural gaps in Europe. First, the reasons for the specialisation of the neighbouring regional economies under the period of the closed border are outlined. Against this background, the repercussions of the partial opening of the border are evaluated in relation to the other driving forces of their development trends in the 1990s. It is concluded that the regions on both sides have lagged behind their respective national averages, although border-related adjustment processes have had quite diverse economic impacts. In Finland, these impacts have remained relatively marginal in most border regions. In the Russian borderlands, some local and regional economies have undergone profound changes in their market orientation due to the proximity of the border; instead of being specialised producers for the Russian market, they are now locked in the international division of labour as economic peripheries.

## 1. Introduction

In recent years, state borders have received increased attention in regional development studies. This interest has been boosted by the debate on the consequences of their transformations; the arguments range from the visions of a borderless world to the findings on how the functions and effects of state borders seem to be relatively persistent even in the conditions of globalisation and European integration (see, e.g., van der Velde & van Houtum 2000, van Geenhuizen & Ratti 2001).

Traditionally, a state border has been conceptualised as an institutional barrier which leads to additional transaction costs in economic interaction, for instance, trade. These costs, deriving from factors such as tariffs and legislative differences, are comparable to additional distance between the regions, which are geographical neighbours but belong to different jurisdictions. This tends to reduce economic interaction between them, and has implications for their roles in the division of labour. Furthermore, the repercussions can be seen in spatial structures, by reason of the fact that border-related barriers are reflected in, for instance, the formation of labour market areas and commuting regions.

Clearly, border-related institutional barriers are not a separate phenomenon, but they are in practice closely linked with other factors which have implications for the behaviour of economic actors. These factors include, for instance, natural conditions, linguistic and cultural differences and missing infrastructure networks. From this perspective, it makes sense to classify border-related barriers according to their resistance to change by human action (see Westlund 1999). For instance, it is possible to manipulate preconditions for cross-border trade and investments by means of political agreements even in a short run, but these measures can be utilised to a very limited extent, if not at all, for purposes of changing mental attitudes and behavioural idiosyncrasies which can be of major importance for the evolution of cross-border economic exchanges.

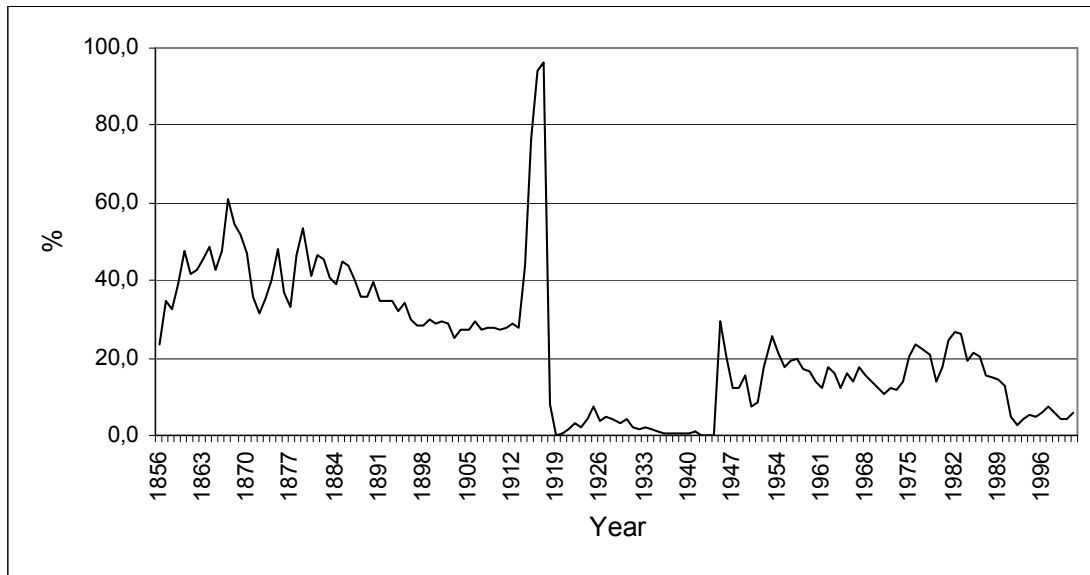
It goes without saying that numerous borders in Europe, as well as ongoing changes in European borderlands, widely deviate from each other. The basic setting comprises two opposite processes: on one hand, the Iron Curtain collapsed around 1990 and institutional

barriers have been abolished on the internal borders of the European Union; on the other hand, new nation states have been established, and their borders erected, in the aftermath of the disintegration of the socialist system. The eastern enlargement of the EU will be the next sea-change, which is bound to undermine the functions of some borders, and emphasise the role of some others as barriers to economic and other human interaction.

The present paper attempts to analyse economic adjustment processes in the borderlands next to the East/West divide in northern Europe. The empirical investigation concerns the Finnish-Russian border regions since around 1990, that is, during the period when direct cross-border links between individual actors have been allowed there. The aim is to reveal the factors and mechanisms through which the partial opening up of the border - it can be said to be ajar now - has been reflected in the economic dynamics of the border regions in the Finnish-Russian case. In particular, it is asked how changes in the volumes and forms of cross-border interaction and border-related disparities are linked to each other. This question derives from the observation that at least thus far, the increased permeability of the border has not implied a decrease in the economic gap on the border. Quite the contrary, this gap has been on an increase, and it is currently one of the widest in Europe in terms of GDP per capita (Alanen & Eskelinen 2000).

Since 1995, the Finnish-Russian border has also been a border - in fact the only land border - between the European Union and the Russian Federation. It deviates from several other eastern borders of the European Union in the sense that it can be assumed to maintain its separating role much longer. Obviously, this emphasises the need to analyse the evolution of regional and local cross-border interaction between Finland and Russia in wider spatial and institutional contexts. The factors conditioning it include the relations of the Russian Federation with the European Union, World Trade Organisation and United States, integration processes in the Baltic Sea Region, as well as bilateral relations between Finland and Russia. All these complex processes are interlinked, and economic and political actors in the borderlands search for their roles in the resulting setting, which historically represents a new phase in interaction between Finland and Russia: see Figure 1.

**Figure 1.** Share of Russia (USSR) of Finland's exports in 1856-2001 (Vattula 1983, and National Board of Customs 1979-2001).



The time-series in Figure 1 supports the view that institutional and political circumstances do matter to cross-border economic interaction. Clearly, the role of Russia as a market to Finnish firms has been conditioned by their changes.

In the following, the research issues are formulated, firstly, by reviewing the roles of border regions in economic and political integration, and discussing possible interdependencies between changes in border-related economic disparities and cross-border interaction (Section 2). Next, in Section 3, the particular border regions are introduced by surveying their roles and developments before 1990 when the Finnish-Russian border was practically closed to local and regional interaction. Section 4 gives an empirical account on economic developments in the border regions and evolution of cross-border economic links and disparities since the early 1990s. Finally, Section 5 attempts to illustrate the mechanisms and consequences of cross-border economic interaction by means of a case study.

The Finnish-Russian border region is approximately 1300 kilometre long in the north-south direction, and it comprises several different sub-regions. The empirical findings in

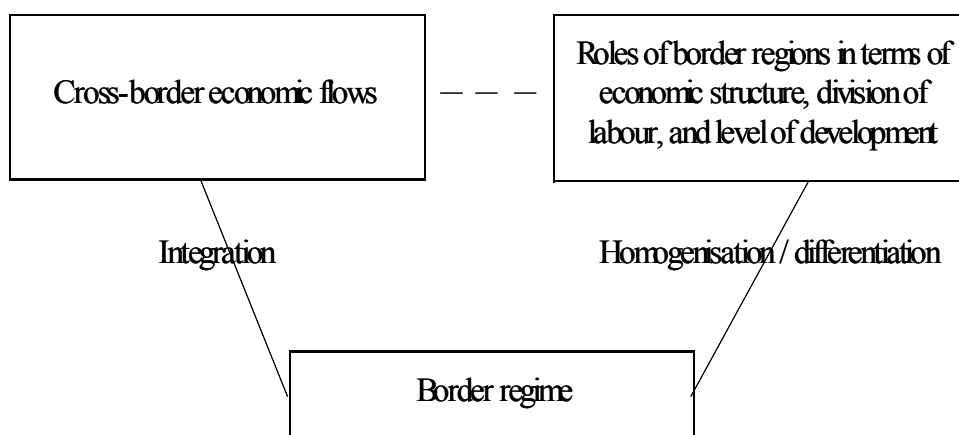
Sections 3 and 4 give a broad overview of the whole region, whereas the specific investigation of cross-border dynamics in Section 5 focuses on the Karelian Republic in the Russian Federation.

## 2. Disparities and interaction

For obvious reasons, the repercussions of international economic integration on the development of border regions form a topical concern in Europe. Several theoretical traditions in economics, classical location theory and new economic geography among them, provide arguments in support of the view that a reduction of institutional barriers related to state borders may contribute to the development of border regions. These regions may benefit from their geographical proximity to export markets, as market areas of companies previously limited by institutional barriers expand. Another possible mechanism derives from the fact that a weakened role of borders has implications for the interplay of endogenous centrifugal and centripetal forces in spatial economic dynamics, which may turn some border regions into transnational centres of economic activity. However, it has to be emphasised that these are only possible outcomes, and one cannot draw the straightforward conclusion that all border regions would benefit from deepening international integration. Thus, the issue remains empirical in the final analysis: border regions form a most heterogenous bundle, and changes in the functions of state borders may have very different consequences in individual regions. (See Niebuhr & Stiller 2002)

As far as economic adjustment processes in border regions are concerned, a pertinent issue concerns - in addition to their performance in terms of economic growth - the relationship between cross-border flows and disparities, that is, whether increased cross-border interaction tends to result in smaller disparities, or vice versa. This setting is outlined in Figure 2.

**Figure 2.** Economic adjustments on the border: interaction and differentiation. <sup>1</sup>



Again, no sweeping generalisations can be drawn concerning the setting in Figure 2. The volume of cross-border exchanges and the differentiation of the two sides of the border are not correlated in any straightforward way, but their interplay may well be characterised by different causal mechanisms. Obviously, disparities between the levels of economic development and related socio-cultural factors derive usually from missing links: limited interaction tends to lead to a cumulation of disparities. Yet this does not imply the conclusion that improved preconditions for cross-border interaction would necessarily imply reduced disparities. On one hand, existing major disparities may well serve as effective obstacles to increased interaction, limiting functional integration processes of the border regions. On the other hand, provided that the neighbouring regions possess complementary resources which can be combined for utilising cross-border synergies, the very same disparities provide incentives to cross-border exchanges, thus accelerating integration processes, (e.g., cheap labour and high-level technological capacity).

In the present case, common institutional preconditions for cross-border interaction in the meaning formal rules (constitutions, laws, property rights) and informal constraints (sanctions, taboos, customs, traditions, and codes of conduct)<sup>2</sup> did not exist, but their creation has been a parallel process to the evolution of the cross-border exchanges. This implies that the two issues of how actors in the border regions have reacted to the existing disparities and complementary resources, and how they have participated in the creation of

preconditions for cross-border exchanges, are intimately related to each other. When analysing this setting, one has to keep in mind that there are different actors involved, and their motives vary a great deal. The relevant economic actors are firms and consumers, whereas public organisations, and at least to some extent also civil society organisations, represent the policy side of interaction, that is, cooperation. This can clearly be seen in the present case; all the above mentioned actors have in one way or another influenced the formation of preconditions for cross-border exchanges, although local and regional actors have to take the formal rules concerning the border regime largely as given.

In the Soviet times, the border regions were parts of the two completely different institutional and political systems, which obviously contributed to growth of disparities between them. Since the partial opening up of the border, this constellation has become much more complicated in the sense that different actors have developed their own rules of conduct, which may well have contradictory implications. Thus, a key question of the empirical analysis concerns the issue of how various actors have reacted to the possibility of crossing the border for whatever purposes, and how this has resulted in various causal links between cross-border interaction and border-related disparities. Another important question concerns possible competition between actors and the distribution of outcomes from cross-border exchanges.

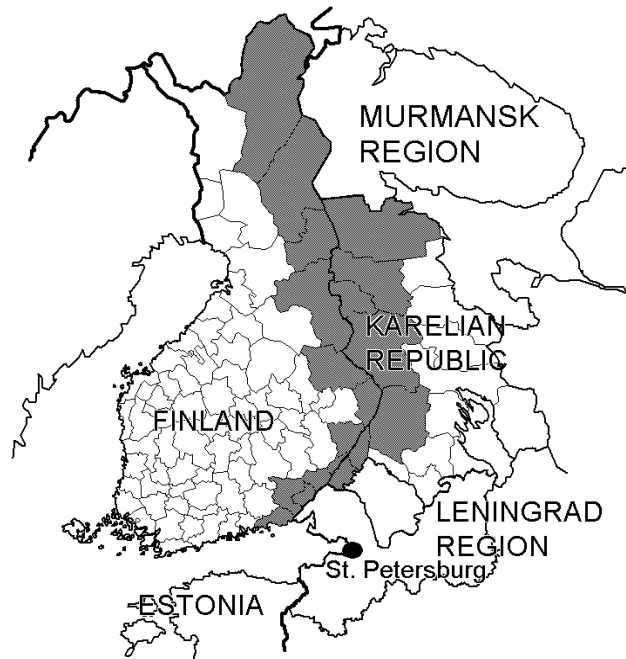
The above mentioned issues are investigated empirically in the following. The surveys in Sections 3 and 4 give an overview on development patterns and trends. Then, a more focussed analysis attempts to uncover causal mechanisms in one particular case.

### 3. Border regions in the division of labour

In the Finnish-Russian case, as in many other European border regions, both the borderline and its functions have undergone a number of changes during the past centuries. Figure 3 describes the current administrative division of the region.



**Figure 3.** Finnish-Russian border region (shaded area = Finnish NUTS4 regions bordering Russia and border districts in the Karelian Republic in Russia (see Table 1)).



When assessing ongoing processes in the Finnish-Russian border region, the most important background factor is the long period of closure, from around 1920 to 1990. At that time, the two sides had completely separate patterns of development, characterised by the features which can be considered as textbook examples of the negative influences of a divisive state border. For instance, the border split functional economic regions and cut off infrastructure networks. The impacts of the metropolis, St. Petersburg, on southeastern Finland ceased after the First World War; in the economic life of the region, it was not any more an important centre of consumption, origin of tourism or destination of migration. Respectively, the second city of Finland, Vyborg, was left on the other side of the border after the Second World War (see, e.g., Eskelinen & Vartiainen 1996).

The about 70-year period of the closed border comprised of two distinctive sub-periods. The decades before the Second World War were characterised by confrontation, whereas political and economic relations between Finland and the USSR were intense in the 1945-90 period (cf. Figure 1). In the present context, however, the issue worth most attention is

the non-existence of cross-border cooperation in the meaning this concept is used in the relevant body of literature: direct cross-border links between economic and other actors were not allowed, and geographical proximity did not play an important role in developing bilateral relations. This can be seen in the fact that the USSR's share of exports was in eastern Finland below the national average. The nature of the border was also clearly demonstrated by the fact that there were only two crossing-points for international traffic, and most border regions of the Soviet Union were completely closed to foreign visitors.

The current administrative division of the Russian northwest dates back to the Soviet period (see Fig. 3). Among the border regions, St. Petersburg (then Leningrad) has been by far the main centre of gravity. Its role in the regional division of labour underwent a complete overhaul as a result of the October Revolution. The capital and the gate to Europe was transformed into one of the main centres of the Soviet military-industrial complex. To a considerable degree, its demand was felt on the surrounding Leningrad region, whose production base included food industry, shipbuilding and energy production.

The more northern border regions, Russian Karelia (the Karelian Republic since 1991; Karelian ASSR in 1956-1991) and the Murmansk region are typical examples of the model by means of which the natural resources of more peripheral regions were taken into use in the Soviet Union. Large industrial complexes were established, often in one-company towns, and in many cases, work camps played an important role in mobilising labour for necessary infrastructure investments (see, e.g., Dmitrieva 1996, Kauppala 2000, Blakkisrud & Hønneland 2001). Due to industrial expansion without major productivity increases, population growth continued in Russian Karelia and the Murmansk region until the final years of the Soviet Union.

Russian Karelia, which is analysed in more detail in Section 5, was developed as a forest industry region in the internal division of labour in the Soviet Union. The regional production complex comprised pulp and paper production, mechanical wood industry, forestry and related engineering industries (forest tractors and paper machines). About one-third of the Soviet Union's newsprint production was in Russian Karelia, and about one-tenth of the pulp production. The Murmansk region, for its part, was developed as a

military base, whose civilian economy relied on mining and fishing industries.

The border regions along the Finnish side of the border did not differ from each other as distinctively as their neighbours on the Soviet side. Already before the closing of the border, Eastern Finland was specialised, quite in line with the standard theory of international trade, on the utilisation of its most abundant resource, timber. The share of the forest sector or cluster has been in recent decades in eastern Finland about two-fold in comparison to the Finnish average, which for its part is very high in a European comparison. Thus, the production structures of eastern Finland and its neighbouring region on the Russian side of the border have in this respect resembled each other, although the driving forces leading to this pattern of specialisation have been quite separate.

In terms of population dynamics, the development path of eastern Finland turned downwards already in the 1960s. Technological and organisational changes cut jobs in the forest sector, firstly in more northern forestry regions and later also in industrial areas in the southeastern part of the region, which led to unemployment and outmigration. This downward trend has continued since then, and the share of the country's eastern part of Finland's economy and population base has declined to a considerable degree in recent decades. To alleviate this problem, specific measures have been implemented, and they have contributed to the growth of new economic activities, which do not rely on the processing of local raw materials. Thus, the economy of eastern Finland has changed towards human capital intensive industries, which attempt to derive their competitive advantage from product differentiation and scale economies. At the same time, the spatial structure of the region has evolved from an areal pattern towards a more nodal one so that currently most local inhabitants live in small urban regions of 30 000 to 100 000 people. Overall, these changes have increased the economic gap between the Finnish and the Russian border regions, and they have also contributed to the depopulation of rural communities next to the border. (Eskelinen 1999)

There is a body of literature analysing preconditions for successful cross-border cooperation and interaction. Using its conclusions as a point of reference (see, e.g. van Geenhuizen & Ratti 2001), the main implications of the above outlined stylized facts are

clear-cut: in comparison to most relevant cases such as the other eastern external borders of the European Union, the preconditions for cross-border integration have to be considered poor in the Finnish-Russian case. In addition to the issues already mentioned, the constraints include the sparse population base, linguistic and other cultural differences, a potential border dispute (the so-called Karelian question, see Joenniemi 1998), institutional incompatibility and lack of infrastructure (incl. border-crossing points).

#### 4. Development trends since 1990

Anticipations concerning prospective impacts of cross-border economic and political interaction run high during the birth of the new Russian Federation. As in many other regions along the East-West Divide, historical experiences were transformed into visions for the future. On both sides of the Finnish-Russian border, the partial opening up process was seen as a major breakup with the past with regard to the region's cul-de-sac position (see, e.g., Katajala 1995).

Immediately, different types of economic and political actors - firms, individual citizens, administrative units and civil society organisations - started to create links across the border. Local and regional actors established contacts with their neighbours, and cross-border tourism and other small-scale economic activities emerged. At about the same time, in 1992, political and economic relations between Finland and Russia were rearranged on a new institutional basis, including an agreement on the so-called neighbouring region cooperation. In this agreement, the Russian Federation accepted the active role of regional administrations in cross-border cooperation and interaction. Yet this did not result in the stabilisation of the institutional basis for cross-border links, but the relevant regulations, domains and procedures have been continuously in the state of uncertainty and flux. (See Eskelinen 2000)

Currently, the first experiences from cross-border links and related developments in the border regions can be evaluated from about one decade's time perspective. In the following, basic trends of demographic and economic developments as well as cross-

border links are described.<sup>3</sup>

As already noted, the border regions' population base is small, St. Petersburg being the obvious exception. Table 1 provides basic data, including a long-term projection for the Finnish regions.

**Table 1.** a) Population changes in the Finnish and Russian border regions (see Fig. 3) in 1990-2000, b) Population forecast for the Finnish border regions until 2030. (NUTS 4 regions in Finland; four subjects of the Russian Federation and districts (rajon) in the Karelian Republic). (Source: Statistics Finland).

a)

Population (1 000s)	1990	1995	2000	1990-2000 % change
FINLAND	4 986	5 108	5 181	3,9
Border regions (NUTS 4)	429	422	400	-6,8
RUSSIA	148 100	147 600	144 800	-2,8
St. Petersburg	5 002	4 769	4 628	-7,5
Leningrad province	1 663	1 668	1 659	-0,2
Karelian republic	798	784	761	-4,7
Border districts	174	170	162	-6,8
Murmansk province	1 177	1 066	989	-16,0

b)

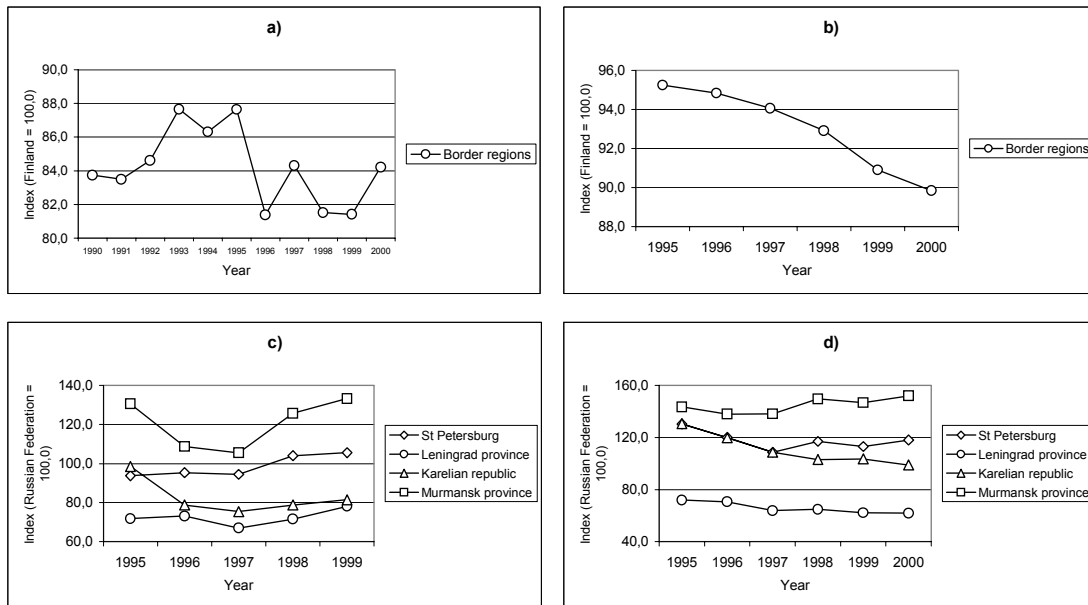
	2005	2010	2015	2020	2025	2030
Population (1 000s)	376	364	353	345	337	328
Share of total population	7,2	6,9	6,7	6,5	6,3	6,2

The most striking observation is that the number of population has diminished in almost all border regions. As a matter of fact, there are only two exceptions to this pattern at the level of NUTS4 regions in Finland and districts in Russia: Lappeenranta in southeastern Finland and Vyborg in Russia, which are both located along the Helsinki - St. Petersburg transport corridor. Of the Russian regions, the Leningrad region has showed more positive developments than the Federation on the average, whereas the trend of the Murmansk region has been most steeply downwards. According the forecast by the Statistics Finland,

the population decline in the Finnish border regions will be prevailing pattern, in terms of NUTS3, NUTS4 and NUTS5 regions.

GDP per capita is the most commonly used indicator of regional economic performance, and disposable income per capita can be used to describe economic welfare. Figure 4 summarises statistical information concerning these key variables.

**Figure 4.** a) GDP per capita in the Finnish border regions (NUTS4, see Fig. 3) in 1990-2000. b) Disposable income per capita in the Finnish border regions (NUTS4) in 1995-2000. c) GDP per capita in the Russian border regions in 1995-99. d) Average income per capita in the Russian border regions in 1995-99. (Source: Statistics Finland. The figures are based on different concepts, and are thus suitable only for intra-country comparisons.)



In Finland, most border regions lag behind the national averages with regard to GDP per capita, and the disparity has not decreased in the 1990s. The redistributive mechanisms, which favour poorer regions, have been curtailed in recent years, and therefore the gap between the border regions and the national average in terms of disposable income per capita was in 2000 wider than in the mid-1990s. On the Russian side of the border, the ranking of the Karelian Republic has lowered in terms of both these indicators.

With regard to the economic gap on the border between the neighbouring regions, the prolonged economic crisis in Russia has been the most decisive determinant. It has

resulted in the widening of the gap so that about one-third of the current disparity derives from the 1990s. (Alanen & Eskelinen 2000)

However, at the same time when the economic gap has grown, most border regions have lost population and they have been laggards in economic development in their national context, border-crossings have been on a sharp increase. In 1990, a bit less than one million people crossed the Finnish-Russian border. The almost continuous growth since then has increased this figure up to 5,6 million crossings in 2001.

There is a lack of statistical data concerning economic flows such as trade and investments between the border regions. In any case, even the more aggregate data in Table 2 makes it possible to draw some tentative conclusions.

**Table 2.** Foreign trade of the border regions. a) Finland's share of the exports of the Russian border regions. (Source: <http://www.hkkk.fi/ecomon>). b) Russia's share of the exports of North Karelia (Finland's easternmost NUTS3 region). (Source: Employment and Economic Development Centre of North Karelia).

a)

	2000	2001
St. Petersburg	8	n.a.
Leningrad province	12	13
Karelian Republic	30	30
Murmansk province	6	8

b)

	1993	1994	1995	1996	1997	1998	1999	2000	2001
Share of exports	3,5	5,2	3,0	3,6	3,3	3,4	2,3	2,3	4,0

Table 2 supports the view that the pattern of trade links is highly asymmetric. First, Finland is a more important market for firms in the Russian border regions than Russia for the firms in the Finnish border regions, although the role of St. Petersburg is also here somewhat different. Secondly, the orientation of the Russian border regions towards the west is not similar; the Karelian Republic being most tightly linked with its neighbouring

Finland.

The differences between the Russian border regions are important also with regard to foreign investments. The city of St. Petersburg as well as the Leningrad region have been relatively popular destinations for foreign investments, although investment volumes are even in those regions small in an international comparison. Among the investors, there are also Finnish firms, especially in food industries and retailing. In contrast, investments in the Murmansk region and in the Karelian Republic have remained negligible after the initial experiments in the early 1990s (see; <http://www.hkkk.fi/ecomon>).

The conclusions from the above observations are fairly clear-cut. In the turbulent years of the Russian political and economic transition in the 1990s, the number of border-crossings has skyrocketed, and Finland has gained an important role as a market for Russian border regions in the adjustment process through which these regions have established direct links with Western European economies. Yet at the time, most border regions, both in Russia and in Finland, have not fared well in national rankings, and the economic gap between them has grown.

At a closer look, there are considerable regional differences in the development patterns and related cross-border links. This is not at all surprising against the background that the border regions' historical legacies are dissimilar, and they display distinctive characteristics also in terms of geographical location, market potential as well as development strategies and policies (see, e.g., Zimine 2001). In the following, the Karelian Republic is put under a closer look. As observed in Sections 3 and 4, it resembles its neighbouring region in Finland in terms of its production structure and it has also oriented itself more strongly towards Finland than the other regions in northwestern Russia, but it has fared worst among the Russian border regions. Here, the main question concerns the mechanisms through which its location on the border has had implications for its development. In this context, special attention has to be devoted to various cross-border actors, that is, to how they have interaction and cooperation, and how they have been involved in upgrading its preconditions.



## 5. More cross-border links, wider disparities: the case of the Karelian Republic

As mentioned in Section 3, the Karelian Republic was specialised in the Soviet times in the forest industry complex, whose main markets were in the European part of the USSR. It has lost these markets almost completely in the transition period since the early 1990s. To a considerable extent, this is due to the fact that its locational position has changed dramatically: when transport costs affect the competitiveness of firms, which was not the case in the Soviet economy, accessibility matters. Simultaneously as the regional economy of the Karelian Republic has turned to western European markets, it has undergone a deindustrialisation process: the bulk of its engineering industries has collapsed, and currently its industrial base mainly comprises production of raw materials and semi-processed goods. This is clearly visible, for instance, in the fact that the exports of roundwood (to Finland) quadrupled, whereas the exports of sawn goods diminished to one-fourth from 1990 to 1998. The proximity of the border has been an important driving force in this restructuring process. Demand by forest-industry companies in the neighbouring region, Eastern Finland, has been reflected in the price of roundwood, which has weakened the competitiveness of local wood-processing firms, and also undermined the attractiveness of the Karelian Republic as a target for foreign investments. Currently, approximately about two-thirds of the industrial and raw material production in the Karelian Republic is exported, Finland's share of these exports being about one-third.

In the same vein as the other regions in the Russian Federation, the Karelian Republic has strengthened its role as a political and institutional actor in the aftermath of the disintegration of the USSR - although it remains an open issue whether this change represents regionalisation by design or by default. In any case, the political initiatives of the Karelian Republic have extended to the realm of international relations. This is shown, for instance, by the fact that it has established a cross-border cooperative region, Euregio Karelia, in collaboration with its neighbouring regions in eastern Finland. The establishment of the Euregio Karelia aims at creating a more permanent institutional basis for joint development strategies across the border. (Cronberg 2000) For the present purposes, however, it has to be emphasised that irrespective of these initiatives, the fundamentals of economic policies clearly remain outside the competence of the Republic.

From the point of view of an export-oriented economy, such as the Karelian Republic, the currency exchange rate is a most important policy parameter, and it is decided at the level of the Federation. The same applies to customs duties and the foreign trade regime in general. Thus, the dynamics of the Karelian Republic is, to a major extent, conditioned exogenously, by the cyclical fluctuations of international markets and by the trade and exchange rate policies of the Russian Federation. In addition, the political and economic turbulence of Russia has been a permanent shadow on all its regions, weakening their competitiveness for foreign as well as domestic investments. Given these obvious limitations of the Karelian Republic with regard to the fundamentals of economic policies, its governments have turned their attention to more detailed forms of policy intervention, by means of which they have tried to secure raw material supplies to firms and repatriate export incomes to the regional economy. However, this kind of policy activism does not encourage prospective foreign investors, but rather has adverse effects. In these conditions, also investments in assembly-type manufacturing production have remained negligible, even if the major difference in production costs is a clear-cut incentive to foreign firms. Another reason for the lack of investments is the production structure of eastern Finland: labour intensive manufacturing production such as clothing and electronics industries, which could benefit from low labour costs of subcontractors next door, do not play any important role there.

As a whole, the Karelian Republic is caught in the development trap of a raw material exporter, the formation of which has been influenced by the proximity of a border. (Druzhinin 2001) Its geographical location has provided the regional economy with access to new markets, but it has been difficult to expand the production capacity in the conditions when local raw materials have competitive uses and economic policies have to be taken as an exogenous variable. Yet it has to stressed that this is only one part of the story on how the impact of the border has been felt in the Karelian Republic.

The major economic gap on the border has provided many opportunities for small-scale, more or less informal economic activities by individual citizens. In a small regional economy such as the Republic is, their impact is considerable. This was observed in a case study concerning a border town (district) on the Russian side. Finnish visitors to the town

of Sortavala (with approx. 35 000 inhabitants) were found to purchase goods and services (typically petrol and alcohol) of the monetary value which is more than ten-fold in comparison to the municipal budget. (Eskelinen & Zimine 2001) For the most part, this business activity is not registered in official statistics, and there are negative externalities such as crimes and diseases linked with it. Yet, together with shuttle-trading and other short-term visits by local inhabitants to Finland, it has formed the main income source to many people in the turbulent circumstances of the Russian transition. Overall, these typical border activities, bazaar economy and shuttle-trading, have in a way compensated for the deindustrialisation in the formal economy caused by price increases. On the other hand, one may well ask whether informal economic activities crowd out people from the formal economy, and what will be the repercussions for the development of human capital in a long run.

## 6. Conclusions

Obviously, the prolonged economic and political crisis in Russia has, to a major degree, conditioned developments even in the northwestern regions of the Federation. However, these regional economies also display characteristics which derive from their location close to the border of Finland and the European Union. This geographical proximity has provided these peripheral border regions with possibilities to initiate economic interaction and create cooperative political relations with their neighbours and other western European partners.

In general, the experiences of the border regions in the North-West Russia demonstrate that increased cross-border interaction does not necessarily imply smaller cross-border disparities. In the present case, even if the transition crisis is the main reason for the widening disparities, the pattern of cross-border economic interdependencies seem to have worked to the same direction. Major institutional and socio-cultural differences, political risks caused by the Russian crisis, and also the spacio-economic structure of the border regions (in particular, the lack of economic actors and infrastructure in these peripheral regions) have contributed to the fact that large differences in production costs have not

been sufficiently lucrative incentives for attracting investments.

The development of the Finnish-Russian border regions and their mutual links can be interpreted in terms of the concept “active space” (van Geenhuizen & Ratti 2001). According to it, the key issue concerns whether economic and other actors in the border regions are able learn together, and establish a joint strategy for improving their competitive positions by means of cross-border synergies and upgrading their positions in relation to their respective national centres of decision-making (cf. Blatter & Clement 2000). From this perspective, an important dilemma of the cross-border interaction and cooperation in the Finnish-Russian case is in that different forms of border-crossings - formal economic links, informal business activities by individual citizens, official political cooperation by actors at various spatial levels, and interaction between organisations of the civil society - have evolved quite separately from each other. Their interdependencies have remained minimal; for instance, cross-cultural competencies which have been created among the local citizens have not yet been identified in the formal political and economic cooperation. In particular, as economic actors in eastern Finland have not had major interests towards Russia, programmes of political cooperation have been implemented separately from cross-border economic interaction. One reason for this state of affairs is also the fact that precautionary measures against the so-called soft security threats - quite understandably as such - have been the main motive for cross-border cooperation. In any case, a more integrated cross-border strategy is clearly needed, as it is obvious that the widening of the economic gap tends to fuel soft security threats.

## **Endnotes**

<sup>1</sup> Adjusted from Rietveld (2001); originating from Cattan & Grasland (1992).

<sup>2</sup> Institutions refer here to “...the humanly devised constraints that structure political, economic and social interaction.” (North 1990, 97).

<sup>3</sup> Here, the most important source is the Economic Monitoring of North-West Russia, Biannual Economic Review (2000-2001). It has produced comparative reports on economic development: see <http://www.hkkk.fi/ecomon/>

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