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## Socio-economic development of border municipalities: the cases of Vyborg and Sortavala

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**The 43<sup>rd</sup> Congress of the European  
Regional Studies Association  
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Jyväskylä, Finland**

**Economic development of border municipalities:  
the cases of Vyborg and Sortavala**

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work in progress, comments are welcome

**Abstract:**

Vyborg and Sortavala are two Russian municipalities situating on the border with Finland. Since the collapse of the Soviet Union they have become arenas of competition between the European and Russian mega-projects, which occurs at the national, regional and municipal levels and has at least three dimensions: political, economic and cultural. This paper traces the relationship between current economic development of these municipalities and their participation in the Russian mega-project.

Russian federal and regional authorities demonstrate duality in their approaches to cross-border interaction. This duality testifies that the Russian elite is divided into agents of pro-European integration subordinating Russia to the EU, and those dedicated to the independent Russian mega-project. This contradiction results in the persistent instability of the Finnish-Russian border regime and significantly affects development patterns of border regions.

The economic crisis of the last decade has stimulated re-orientation of Northwest Russia from domestic to foreign markets. Export of natural resources has integrated North-western regional economies with the EU. Their reliance on exports has been the only possible survival strategy amidst the Russian turmoil of the 1990s. Now export of natural resources becomes part of Russia's new geo-economic project: export earnings are to be used to finance internationally competitive Russian high-tech industries. This is the core idea of Russia's present economic development strategy in which Vyborg and Sortavala play certain roles. Thus, Vyborg is set to secure Russia's transportation independence, while Sortavala develops as a major spiritual centre projecting Russia's traditional values to the Russian Northwest and beyond.

## 1. Introduction: five Eurasian mega-projects

Since the fall of the Iron Curtain and the dissolution of the USSR the new geo-political, geo-economic and geo-cultural reality has necessitated a profound re-formulation of the dominating mega-projects,<sup>1</sup> which are being implemented on the Eurasian scale. The future of Russia has become one of the main problems of this Continent. Will Russia remain an independent subject of historical creativity or will it be divided or turned into an object of external manipulation? This is an open question. We already witness 'a war for the Soviet legacy'. At least five 'civilisational' actors take part in this conflict: the EU, the USA, China, the Islamic World, and those who can be called 'heirs of the Russian Empire'. These actors are creating a new geography of political, economic and cultural zones of their influence in this part of the world.

The interests of the actors are clearly defined. The EU seeks to acquire new territories in the East in order to solve some of its acute demographic, cultural and economic problems. Facing the depletion of energy resources in the North Sea region, the EU needs to increase Russian exports of oil, gas and other natural resources. Russia can also be a source of cheap labour and a sizeable market for European goods and services. That is why the EU needs a predictable, stable, manageable and weak Russia, and a Russia with poor investment climate, which would never compete with the EU on the global investment market. Moreover, the EU needs Russia as its Eastern buffer security zone protecting the Union from illegal immigrants, as well as from illegal drug smuggling. These objectives can be easily discerned in the EU common strategy on Russia adopted in 1999.<sup>2</sup>

In order to achieve these goals the EU has actively pursued the policy of its eastward expansion. This expansion has followed two distinctive routes: (1) the physical inclusion of some East European countries into the EU and (2) skilful propaganda of Western values in Eurasia. For instance, in respect of Russia the EU has attempted to guide this country's social, economic and political development through various kinds of technical assistance, trade regulations, ecological standards, civic norms, etc. Many of these norms and values have been in a sharp contrast with Russian traditional values and national interests. Nonetheless, the European project has won many adherents in Russia, even amongst high-ranking governmental officials and intellectuals struggling to prove that 'Russia is part of Europe'.<sup>3</sup> As a result, Russia has again become deeply divided between 'Slavophiles' and 'Westernisers', just like it was in the 19<sup>th</sup> century.

The USA have been also very active in Eurasia. They have pursued an ambitious agenda involving a number of important political, economic and security aims. The USA seek to strengthen their global military, economic and ideological dominance either by direct interference in domestic affairs of 'rogue states' or by spreading the ideology of globalisation and other American ideas. Russia has not escaped this influence. Russian national interests clash with those of the USA in many fields ranging from foreign trade to preserving Russia's sovereignty in its domestic affairs.

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<sup>1</sup> A mega-project is a present development strategy of a given civilisation. The term civilisation should be understood in the geopolitical sense, see Huntington (1996).

<sup>2</sup> It is available at: [http://europa.eu.int/comm/external\\_relations/ceeca/com\\_strat/russia\\_99.pdf](http://europa.eu.int/comm/external_relations/ceeca/com_strat/russia_99.pdf)

<sup>3</sup> See, for example, Kantor (1997).

China has posed a different sort of challenge for Russia in the Far East. At the time of rapid depopulation of the sparsely populated Russian Far East (RFE), population density and growth rates in the neighbouring Chinese provinces have been very high. It is well possible to imagine such a situation when in the nearest future the almost empty space of the RFE can be peacefully occupied by the Chinese. Chinese immigrants have already occupied important positions in trade, manufacturing and agriculture in some of Russia's Far Eastern provinces. Chinese corporatist social organisation is apparently more suitable for territorial conquest than the Russian presently atomised society, weakened by decades of Communist rule.

The Islamic World has also played an increasingly important role in post-Soviet Russian affairs. Russian Islamic provinces, particularly Chechnya, Tatarstan and Bashkortostan, were in the focus of Moscow's attention throughout the 1990s because of their strong defiance to play by the rules of the federal centre. In Chechnya the conflict has taken the form of an open war, while in other places it has assumed more subtle, but not less dangerous, forms. In fact, Russia has collided not only with a few independence-minded regions, but with the formidable mega-project of world-wide expansion of the Islamic World, equally affecting Russia and many other countries. Again, as in the case of Chinese migrants in the RFE, the present Russian modernised anti-traditionalist society can hardly withstand the impact of Islamic traditionalists.

Finally, Russia's own mega-project has been carried out by the 'heirs of the Russian empire' who aim at preserving the country as an independent subject of international relations on the basis of reviving its traditional culture, integrating its separated parts and securing full control over its territory and resources, broadly defined. Russia's integration with Belorussia is one step in this direction.<sup>4</sup> The Russian mega-project is far from being nationalistic or isolationist. It can rather be called imperialistic and expansionist. For its implementation, common values of the Russian tradition are more important than ethnic origins of its participants.<sup>5</sup> Unfortunately, the project is still not formally institutionalised. It exists as an informal agreement amongst part of the Russian elite. Its strategy and agenda are gradually emerging from intellectual discourses in the contemporary Russia.<sup>6</sup> More importantly, this mega-project is supported by the very mentality of Russian citizens brought up on the values of Orthodox Christianity and traditional Islam, which could not be exterminated or altered by decades of Communist rule with its ultra-modernist zeal.

In this context the study of Russian borderlands becomes the study of the struggle amongst these mega-projects. Stretching along state boundaries, border areas are immediately exposed to competing ideologies and policies. Economic development of borderlands becomes one of the key fields of such competition. Regional development is subjected to geo-economic considerations, which significantly affect development patterns of border areas. This paper analyses how the EU's and Russian mega-projects

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<sup>4</sup> For instance, it has been agreed that beginning from 1<sup>st</sup> January 2005 these countries will use a single currency – the Russian rouble.

<sup>5</sup> The Eurasianist Party and neo-Communists play leading roles in this movement (Dugin, 1997).

<sup>6</sup> See, for example, Clover (1999), Ingram (2001) and Tsygankov (1998).

influence economic development of Russian border municipalities, taking Vyborg and Sortavala as case studies.<sup>7</sup>

In doing so the paper seeks to challenge the ideology of Russia's integration with the EU.<sup>8</sup> The paper shows that the situation is more complicated. The strategic interests of Russia and the Union do not coincide. The most fundamental difference stems from their different choices between economic development and identity. It seems, European countries are ready to sacrifice their identities for the sake of the development and the mythological 'Europeanness', whereas for Russia its traditional identity has always been more important than material well-being. At present Russia rediscovers its roots, and this difficult process bears new tensions and divisions within the Russian society. This partially explains Russia's seemingly 'irrational' behaviour and failures in building a 'normal' democratic capitalist state. Both Vyborg and Sortavala are good examples in this respect.

**Map 1. Northwest Federal District of Russia**



Source: <http://www.gov.karelia.ru>

The paper is divided into three sections analysing respectively the federal, regional and municipal levels of cross-border relations. Each of these sections looks at the political, economic and cultural dimensions of these relations. The paper draws on public media discourses, interview materials, and recent statistical data.

<sup>7</sup> Vyborg is situated in Leningrad Oblast', while Sortavala – in the Republic of Karelia, both in Northwest Russia bordering on Finland and the EU (see Map 1). In this paper terms 'oblast', 'region' and 'province' are used interchangeably.

<sup>8</sup> Surely, proponents of the integration mean only economic and cultural, not political, integration.

## 2. The Russian divide: conflicting development trends

### 2.1. Federal level

Since the demise of the USSR and Finland's accession to the EU in 1995, the Russian border zone along the Finnish boundary has once again become a contested area between the Russian and European mega-projects. The border regime has been significantly liberalised, and the border zone has become wide open for external influences, while Russian influence has declined. No more Russia's formal control over this territory means that Russia is the only civilisational actor operating in this area and using it for its own benefit.

The greatest challenge for Russia comes from the domain of ideology. Since the beginning of the Cold War, Russia has been exposed to intensive propaganda of Western norms and values.<sup>9</sup> In the late 1980s the most prominent political figure performing this task was General Secretary of the Communist Party Mikhail Gorbachev. After the fall of the Soviet Union, this propaganda has assumed new, more open and aggressive, forms. Especially threatening is the Western *religion* of liberalism waging a fierce war against traditional religions, particularly against the true (Orthodox) Christianity.<sup>10</sup> Nonetheless, at the same time, Gorbachev's political liberalisation has given Russian people the opportunity to find the true purpose of Russia, not distorted by both the communist and liberal ideologies.

As a result, the contemporary Russian society has become deeply divided. The choice is simple: either (1) Russia becomes a 'normal' state with lower-middle incomes, part of the Western civilisation and a slave of liberalism<sup>11</sup> or (2) it remains sovereign, pursues its own development path and continues to fulfil its mission as the only major civilisation confessing Orthodox Christianity in this world. The first and second ways collide with each other in the minds of Russian leaders and ordinary people, and this collision leads to contradicting reactions and policies. The absence of a coherent strategy was particularly glaring in the first half of the 1990s. However, since the second half of that decade, the second option has become relatively more pronounced than the first one.<sup>12</sup> Nevertheless, the contradictions have still remained.

The central contradiction, equally affecting border and non-border territories of Russia, lies in the field of cultural policy. On the one hand, public mass media propagate liberalism and Western lifestyles, and the state introduces liberal innovations in politics, education and in many other aspects of social life. On the other hand, the state does not oppose the revival of the Russian Orthodox Church, and even in many instances provides it with various forms of state support.<sup>13</sup> Nonetheless, after the 75 years of persecution by the state, the Church is still very weak to

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<sup>9</sup> It should be noted, however, that Western influence upon Russia has a very long history, which cannot be discounted. The struggle of the Russian and European civilisations can be traced back at least to the 13<sup>th</sup> century, to the time of Teutonic Crusades to the Russian Northwest.

<sup>10</sup> The fact that liberalism is a religion is well-illustrated by Mozharovsky (2002).

<sup>11</sup> By the way, this will inevitably lead to a partition of Russia between Europe, the USA, China and the Islamic World. Already now different parts of Russia gravitate towards different foreign centers of influence.

<sup>12</sup> See Clover (1999) and Tsygankov (1998).

<sup>13</sup> See, for instance, Bacon (2002) and Verkovsky (2002).

comprehensively defend Russia's spiritual space and spiritual borders. Numerous social ills of modern Russia can be directly attributed to the insufficient involvement of the Church in social affairs, as well as to the intensive propaganda of Western lifestyles. Russia has *de facto* almost surrendered its spiritual space to Western invaders. Now it is time to take this space back. Apparently, the current Russian leadership has gradually understood that the Orthodoxy is the core of Russian identity. Without the Church there will be no Russians, but only post-modern pagans leading a spiritless life. Hopefully, this understanding should lead to a radical change in Russia's cultural policy.

Moscow's border policies have also been rather contradicting. On the one hand, the federal government has sought to achieve greater integration with Europe through liberalising the border regime, allowing the creation of Euroregion Karelia, and even offering some opportunities for visa-free travel to Russia. On the other hand, the EU's reluctance to grant similar preferences to Russian citizens and especially the eastward enlargement of the EU and NATO has resulted in a notable hardening of the border regime. Russian foreign policy has become more realistic as the leadership has come to a clearer understanding of Russia's new place in the world. The principle of reciprocity has remained the cornerstone of Russian foreign policy.

For example, two Finnish ferry companies Silja Line and Christine Cruise have recently become a source of Finnish-Russian conflict. They planned to run ferries respectively from Helsinki to St. Petersburg and from Kotka to Vyborg. According to the Russian Law on Entering and Leaving the Russian Federation (1996), foreign citizens may enter Russia visa-free for up to 3 days on board of cruise ships. However in August 2002 the Russian Ministry of Foreign Affairs issued a decision stating that the ferries of Silja Line and Christine Cruise cannot be regarded as cruise ships, and therefore, their foreign passengers must have Russian visas. As a result, the shipping companies have cancelled their tours to the Russian ports.<sup>14</sup>

Apparently, the Ministry strictly adheres to the principle of reciprocity: if Russian citizens are denied certain rights abroad, then foreign citizens must be denied the same rights in Russia. A similar approach was demonstrated a couple of years ago when Russia abolished the Vyborg Card Scheme, which allowed Finnish citizens to enter Russia visa-free for up to 3 days for a nominal annual fee of about 20 euros. By organising this scheme Russia demonstrated its readiness to open the border wider. It was expected that Finland should make a reciprocal step. But instead Finland joined the Schengen Zone, and such a step became impossible.<sup>15</sup>

Obviously, this visa policy contradicts the interests of economic development of border municipalities, which benefit most from substantial inflows of Finnish tourists. However, lesser dependence on tourism may well stimulate the development of other economic sectors oriented on the domestic market, which would be in line with core ideas of the Russian mega-project.

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<sup>14</sup> Vil'de, Tatiana (2003), 'Finlyandskie paromy zhдут pozitsii MID', *Delovoi Peterburg*, 17 Feb.: 4.

<sup>15</sup> Likewise, Russia has abolished the visa-free regime for Finnish citizens travelling through the Saimaa Channel linking the Finnish Saimaa lake with the Gulf of Finland on the Russian territory (the Vyborg municipality). Now Finns need group visas to enter Russia.

A similar duality can be observed in Russian economic policies. While declaring a liberal policy of 'marketisation' and integration of Russia into the global economy (e.g. through joining the WTO), Russian economic authorities have not hurried to create a favourable climate for foreign investments. Even those investment incentives which existed in the late Gorbachev period (e.g. tax breaks and special preferences for joint ventures) have been abolished immediately after the collapse of the USSR. Likewise, the Russian Government has opposed plans to set up free economic zones (FEZ) explaining that such zones represent a potential opportunity for tax evasion. For instance, in Northwest Russia FEZ have failed to materialise in Vyborg, Sortavala, Kostamuksha and Svetogorsk – the municipalities lying along the Finnish-Russian border. More importantly, the would-be liberalisation of economic life contradicts the interests of Russian bureaucracy seeking to retain its full control over the economy. Russian bureaucrats, in fact, act as feudal rulers, thus re-creating Russia's traditional forms of economic life and making it all but impossible to integrate Russia into the global economy.<sup>16</sup> This semi-autarky gives Russia time to consolidate its own economic mega-project.

Customs regulations represent a major field of conflicting interests. On the one hand, Russia declares its commitment to free trade and tries to upgrade its customs service up to international standards. In many cases this work is done on account of European technical and financial resources. For instance, a number of new border-crossing points have been built in Vyborg, Svetogorsk and Sortavala on account of EU's Tacis Programme. On the other hand, customs regulations are clearly designed to function as a strict border separating Russia's economic space from the world.

In general, protection of Russia's domestic producers prevails over the ideology of free trade, although in some cases the Russian Government demonstrates more liberal approaches. For example, in 2002 the Russian Federal Customs Committee issued an order to close a majority of temporary border-crossing points on the Finnish border, which were used mainly for exporting roundwood from the Russian five-kilometer border zone in Karelia and Leningrad oblast'. The reason of this decision was that it was difficult to control timber exports going through these points. A week later, after a wave of protests of timber exporters, this order was cancelled with the promise to introduce it again at a later date.

Customs duties and regulations have been an important factor affecting trade between Russia and Finland. On the one hand, the EU sets protective barriers against higher-added-value Russian goods thus stimulating only Russian exports of raw materials. On the other hand, Russian Customs Committee often increases export duties on raw materials, which makes their export less profitable and sometimes even impossible. The 'customs factor' makes cross-border trade very volatile, which negatively affects regional economic development, particularly in such non-diversified regions as Karelia. Russian import tariffs have also caused serious problems. For instance, they effectively prevent Russian companies from importing advanced foreign technologies and equipment. Import regulations are often used for retaliation in trade conflicts. For example, in 2002 Russia introduced a ban on imports of American chickens as a response to US anti-dumping measures against Russian steel producers. Of course,

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<sup>16</sup> This observation is characteristic of not only federal bureaucrats, but even more so of regional ones. See Ericson, Richard E. (1999), The post-soviet Russian economic system: an industrial feudalism? SITE Working Paper No. 140 (available from <http://www.hhs.se/site/research/workingpaper.htm>).



such policies have a direct impact on border regions actively participating in foreign trade as logistical centres.

External economic environment has greatly contributed to Russia's economic self-consciousness. Double standards and anti-dumping procedures against Russian producers have aptly demonstrated the real rules of the global economic game. As a result, Russia has ceased to follow foreign recommendations and begun to search for an independent endogenous way of economic development. It appears now Russian development strategy dwells upon the idea to revive domestic high-tech industries on account of proceeds from exports of natural resources.<sup>17</sup> Another pillar of the strategy is to consolidate Russian influence in the neighbouring countries of the former Soviet Union, particularly in Ukraine, Belorussia and Kazakhstan. Their re-union with Russia should have a powerful synergetic effect. Finally, Russia strives to achieve greater geo-political independence, first of all in the field of transportation. Thus, instead of continuing deliveries of Russian oil and natural gas to Europe via the Baltic states, Russia has begun the construction of new seaports and pipelines bypassing these states. Russian Northwest plays a decisive role in these plans.

## **2.2. Regional level**

At the regional level the struggle between the European and Russian mega-projects has been not less acute than at the federal level. On the one hand, both Karelia and Leningrad oblast' have proclaimed their interest in closer cross-border co-operation (CBC). They have actively participated in various EU-sponsored schemes and organisations. Karelia has even established a cross-border Euroregion, together with three Finnish provinces, in order to promote more active CBC. The Leningrad province has supported CBC mainly by its successful foreign investment promotion policies. More importantly, because of the prolonged economic crisis in Russia, the regional economies have re-oriented towards European markets and become dependent on export of natural resources. The reliance on exports was, perhaps, the only possible survival strategy amidst the Russian turmoil of the 1990s. This situation has firmly involved these regions into the sphere of European influence.

However, on the other hand, Karelia and Leningrad oblast' have continued to play certain roles in the Russian mega-project. Thus, Karelia has largely preserved domestic control over local natural resources and major enterprises, while the oblast' has played an instrumental role in the construction of new sea ports securing Russia's transportation independence from the EU.<sup>18</sup> Regional authorities in both the provinces have been also very active in their support to the Russian Orthodox Church. Moreover, since the late 1990s, particularly after the 1998 financial crisis, the regional economies has been increasingly re-integrated with the Russian economy as a whole. This re-integration has been based on inclusion of some key regional enterprises into the leading nation-wide financial industrial groups. For example, in Karelia the Kostamuksha Mining Combine has been acquired by the Severstal' Corporation from Cherepovets, the leading producer and exporter of steel. Likewise, in the Sortavala municipality the Värtsilä Metals Plant has been purchased by the Mechel Group from Chelyabinsk. These cases illustrate the beginning of consolidation of the Russian

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<sup>17</sup> Russian Economic Development Strategy till 2010, available at <http://www2.kodeks.net>

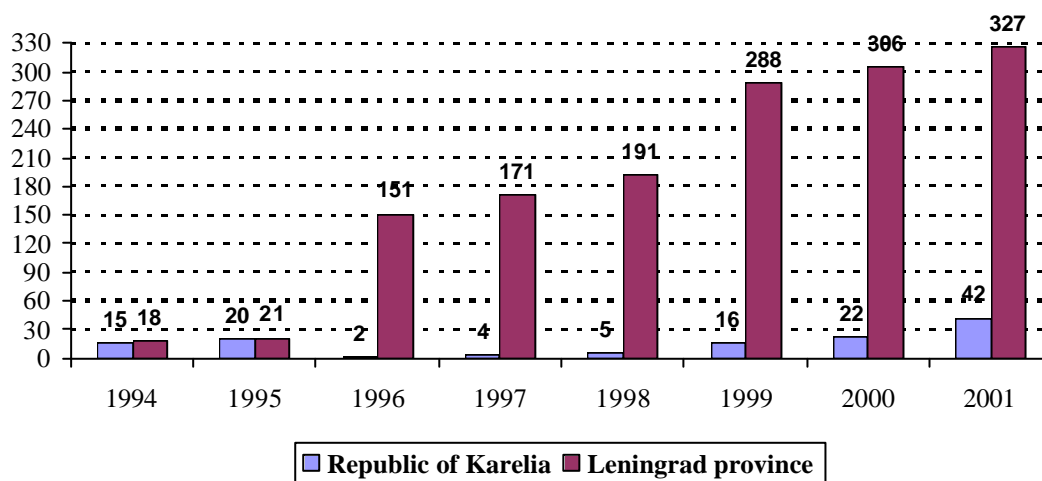
<sup>18</sup> These construction projects were initiated by then Governor of Leningrad oblast' Vadim Gustov.

economy, which is vitally important for the future success of the Russian mega-project.

The Leningrad province and Karelia have differed from each other in terms of their economic policies. The province was more liberal. This region has supported the development of the private sector by such measures as tax breaks and special investment promotion policies. The Leningrad province was greatly influenced by the example of the neighbouring Novgorod province, which was very successful in the field of investment promotion. Learning from its experience, the Leningrad province has also begun to apply neo-liberal and neo-institutionalist methods of inward investment promotion, and succeeded in doing this.

The Leningrad province began its large-scale promotion programme in 1996. Generous tax incentives in combination with the advantageous geographical location, have resulted in a substantial inflow of foreign investments (Figure 1). The bulk of foreign money was invested in the tobacco, timber and machine-building industries. The United States have been the main investor in the Leningrad province. Amongst the most important American companies investing here are Ford (automobiles in Vsevolozhsk), Caterpillar (road machinery in Tosno), International Paper (paper in Svetogorsk) and Philip Morris (tobacco products in the Lomonosov). In 2002 the Leningrad province occupied the 10<sup>th</sup> place amongst Russia's 89 regions in terms of attractiveness of regional investment climate.<sup>19</sup>

**Figure 1. Foreign investments, US\$ million**



Sources: NEBI Yearbook 2001/2002 and <http://www.hkkk.fi/ecomon>

In Karelia the situation has been quite the opposite. Tax rates were set at their maximum possible levels, and the Republican Government tightly restricted corporate mergers, acquisitions and restructuring programmes. The Karelian Government was very protective in respect of local industries and regarded external investors as a threat to regional political stability. The reasoning of the Government may well be

<sup>19</sup> Karelia was on the 31<sup>st</sup> place. Source: 'Investment ranking of Russian regions 2001-2002' (in Russian), *Ekspert*, 2 December, 2002: 106-107.

understood. A radical restructuring in Karelian timber industry can increase its overall efficiency, but the introduction of new technologies can also lead to higher unemployment and social unrest with clearly distinguishable consequences for the current political leadership. That is why the Karelian Government has been rather reluctant to let the restructuring happen. Perhaps, a certain role in preserving the *status quo* has also been played by Karelian bureaucrats with their rent-seeking attitudes in respect of their jobs.

It should be mentioned that Karelian investment image has been seriously damaged by a scandal with Swedish company Assi Domän, a major producer of paper products. In the mid-1990s this company bought the Segezha Pulp-and-Paper Mill and tried to upgrade its outdated equipment. However, fundamental disagreements with the Karelian Government over old debts and social contributions have forced Assi Domän to abandon this venture. Since then foreign investors have treated Karelia very cautiously. Nonetheless, the Segezha Mill has been subsequently acquired by a group of Russian investors, who have managed to revive this enterprise and even make it one of the most successful companies in Karelia.

In sum, it can be said that the influence of the EU in Karelia and in the Leningrad province is very considerable, but it is counterbalanced by integrative trends within the Russian economy, as well as by pragmatic rent-seeking on part of regional bureaucrats. In comparison with Karelia the Leningrad province has advanced much farther on the way of European integration. However, despite its Western orientation in terms of both trade and investments, the province plays a key role in the projects aiming at achieving Russia's transport independence. At the same time, the Republic of Karelia maintains an asymmetrical autarky: in terms of foreign trade it is oriented on the EU, while in terms of investments it remains isolated from the West.

### **2.3. Municipal level: Vyborg and Sortavala**

Vyborg and Sortavala are similar in many respects. Both of them were built by the Swedes back in the Middle Ages. Both of them belonged to Finland and were ceded to Russia as a result of the World War II. Both of them are now situated on the Finnish-Russian border, and both have direct access to major waterways: Vyborg – to the Gulf of Finland and the Saimaa Channel, and Sortavala – to Ladoga lake, the largest lake in Europe which is connected to the Baltic Sea through river Neva. The Vyborg municipality is situated in the Northwest of the Leningrad province, while Sortavala occupies South-western part of the Republic of Karelia. The territory of the Vyborg municipality includes numerous islands in the Gulf of Finland, while Sortavala includes the Valaam Archipelago in Ladoga lake.

Vyborg is the largest municipality in the Leningrad province with the population of 172.8 thousand of which 78.6 thousand live in the town of Vyborg. The population of the Sortavala municipality is 34.6 thousand of which 19.4 thousand live in the town of Sortavala.<sup>20</sup>

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<sup>20</sup> As of 1<sup>st</sup> January 2002 (Peterburgkomstat, 2002: 10, 12 and Karelkomstat, 2002: 6, 9).

In the 1990s both municipalities suffered a severe economic decline which was deeper than that in their respective regions. This is reflected in both employment and output figures. The situation has been particularly difficult in Sortavala, where the only large industrial enterprise, a wooden furniture factory, went bankrupt (Table 1). In order to compensate for the loss of job, many people have found jobs in the informal sector, which grew rapidly in the 1990s. A large share of people have resorted to subsistence farming. This has been typical for peripheral areas. In border areas informal economic activities have been centred around cross-border petty trade (also called ‘shuttle trade’) and illegal activities, such as prostitution and crimes against foreign visitors.

Table 1. Change in the number of employees in large and medium-sized enterprises, percent

	Industry	Agriculture	Construction	Other	Total
Sortavala (1991-2001)	-69,0	-63,9	-58,1	-19,4	-43,3
Vyborg (1992-2002)	-55,4	-45,4	-92,7	3,5	-33,4

Sources: regional statistical committees

Shuttle trade is well-developed in the Finnish-Russian border area. It is fuelled by a wide difference in personal incomes and in retail prices. Prices in Russia are much lower than in Finland. It is possible to name three contributing factors: (1) excise taxes on alcohol and tobacco products are much lower in Russia; (2) production costs are also lower, mostly because of cheaper labour costs and lower energy tariffs; and (3) copyright laws are often violated in Russia, which makes illegally produced goods cheaper. This situation stimulates two-way shuttle trade: Finnish citizens come to Russia to buy local goods, while Russians travel to Finland to sell something there, especially alcohol, cigarettes and music records. In addition, in Finland Russians buy (or even take free of charge) second-hand domestic appliances, such as TV sets, videos and refrigerators. These appliances are then sold at a profit in Russia. Apparently, this trade is supported by auxiliary services, such as wholesalers, specialist shops, tourist firms and transportation companies.

Cross-border labour commuting also becomes an increasingly important feature of Finnish-Russian cross-border interaction. It is especially developed in the timber industry, where Russian firms often hire Finnish companies to log and export timber in the five-kilometer zone along the state border.<sup>21</sup> Likewise, an increasing number of Russian citizens get temporary and permanent jobs in Finland, mostly in education, services and in software development. Russian students and unemployed persons from the border regions often go to Finland in summer to work as seasonal agricultural workers.

Subcontracting has become an increasingly important form of cross-border business co-operation for both Vyborg and Sortavala. In these municipalities subcontracting has been particularly developed in such industries as textiles and metal-working. Subcontracting has allowed foreign companies to take advantage of low labour costs

<sup>21</sup> The Karelian Government regards this situation as a problem, because the Republic does not receive any tax payments from these companies, which are officially tax-exempt in accordance with the Finnish-Russian Treaty on Avoidance of Double Taxation (see Karelian Cross-Border Co-operation Programme for 2001-2006).

in Russia, while, at the same time, to avoid high risks usually associated with direct investment projects.

The municipal economies are dependent on exports of timber and pulp-and-paper products. In the Vyborg municipality the main enterprises operating in this sector are the Vyborg and Svetogorsk pulp-and-paper mills. In Sortavala a leading role is played by the joint Finnish-Russian company Ladenso. It also has a ferrous metal plant in Värtsilä and three quarries producing construction materials (stone, gravel and sand). Vyborg has three seaports: Vyborg, Vysotsk and Primorsk, and a relatively successful shipbuilding plant, formerly owned by the Norwegian Kvaerner Company.

Both municipalities specialise in transportation and tourist services (hotels, restaurants, tourist companies), as well as have a large share of the population employed in agriculture (mostly involved in subsistence farming). The most difficult problems are inadequate public security and negative image of the municipalities abroad. Thus, because of robberies often committed against Finnish tourists in Vyborg, several Finnish tour operators have recently declared a boycott to this town. This has caused a serious economic damage to Vyborg, which hitherto visited up to half a million Finnish tourists per year.<sup>22</sup> Likewise, Sortavala has often been highlighted in the Finnish press as a centre of child prostitution and of illegal drug trade.

The intensity of cross-border contacts in Vyborg and Sortavala is rather high. For instance, in 2001 Sortavala's residents (34600 in total) made 90000 trips to Finland. In the Vyborg municipality the number of registered cross-border trips has reached one million.<sup>23</sup> The impact of the Finnish-Russian border is visible in statistical data on retail trade turnover per capita. In both Vyborg and Sortavala the turnover is well above the national and regional averages. Thus, in 2001 the turnover in Sortavala was RUR 24977 against RUR 17191 in Karelia as a whole. In Vyborg the turnover was RUR 25600, while in the Leningrad province it was 12984.<sup>24</sup> The influence of foreigners is also revealed in the unusually high spending on services of saunas. Thus, in Sortavala in 2001 per capita spending on sauna services was RUR 43.1, while the republican average was RUR 19.4.<sup>25</sup> Vyborg has developed as a major museum centre, thanks to its magnificent medieval castle operating as a local history museum. Thus, in the year 2000 the number of visits to museums per 1000 citizens was 1010 in Vyborg against 358 in the Leningrad province and 505 in Russia as a whole.

It is possible to discern two key patterns of economic development of the Sortavla and Vyborg municipalities in the 1990s: the lack of foreign investments and a substantial inflow of domestic investments.

In the early 1990s Sortavala experienced a sharp rise in foreign investment activity. About thirty foreign-owned companies were established in the municipality. It was a

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<sup>22</sup> The boycott was cancelled on 14<sup>th</sup> February 2003, Delovoy Peterburg, 17 February 2003: 13 (<http://www.dp.ru>) and 'Voprosy est', otvetov net', Vyborgskie Vedomosti, 14 January 2003, available at <http://info.vyborg.ru/archive/issue31/firstnews/view424.html>

<sup>23</sup> Of course, this figure includes not only residents of Vyborg, but also travellers from outside this municipality. Source: <http://www.rusgate.com>

<sup>24</sup> In Russia as a whole the retail turnover per capita was RUR 21090 (Goskomstat, 2002: 481).

<sup>25</sup> Calculated on the basis of Karelkomstat (2002): 6, 123 and 126.

time of widespread euphoria, caused by the collapse of the USSR and by relaxation of the border regime. Everything was seen through 'rose eyeglasses'. But then, foreign, mostly Finnish, investors faced the hard reality of doing business in the unpredictable environment of post-Soviet Russia. It has soon become obvious that western approaches to entrepreneurship do not work in Karelia in general and in Sortavala in particular. As a result, the number of foreign companies declined to seven in 2000. Sortavala's companies with FDI work predominantly in the timber-logging industry. Typically, Finnish companies get permissions to log timber in the near-border zone using their own equipment and labour force. These operations do not involve Finnish investments in Sortavala. A similar relationship exists in the garment industry: Finnish companies subcontract production of clothes to a Russian-owned company situating in Sortavala. Likewise, this scheme does not require foreign investments.

Notable foreign investments in Sortavala have been made in the non-commercial sector. Thus the EU's Tacis Programme invested in the upgrading of the Värtsilä – Niirala border-crossing point. Tacis also financed a substantial improvement of water treatment facilities in Sortavala and in neighbouring settlements. Some Tacis-sponsored initiatives have been launched in tourism development, public healthcare and environment protection.

It is interesting to note that the largest enterprise with foreign participation operating in Sortavala, the timber-logging Ladenso company with Finnish investments, is registered not in Sortavala, but in the neighbouring Pitkäranta municipality. Another major company, which will be built in this area, a large saw-mill of Stora Enso, will be also situated and registered in Pitkäranta, despite the fact that initially Stora Enso planned to build it in Sortavala. The talks about this project lasted between Stora Enso and the Karelian Government for almost a decade. In general, it is not surprising to observe the lack of foreign investments in Sortavala, given the generally poor investment climate in Karelia.

In Vyborg the situation with foreign investments has been similar to that in Sortavala. Foreign investors came to Vyborg and quickly left for other places. Thus, Ford Motors Company initially planned to set up its car assembly factory in Vyborg, but after a careful consideration preferred to locate it in Vsevolozhsk. Other major investment projects in the Leningrad region also bypassed Vyborg, despite its supposedly advantageous position along the Russian-Finnish border. Thus, a cigarette factory of the American Philip Morris Company has been built in the Lomonosov municipality, another US firm, Caterpillar, has built a plant in Tosno, while a number of sizeable timber-processing ventures have been established by Finnish and Swedish firms in the Tikhvin, Lodeinoe Pole and Podporozhie municipalities on the East of the Leningrad region, as well as in the Novgorod province. Another example: the Norwegian Kvaerner company acquired the Vyborg Shipbuilding Plant, but was forced to sell it a couple of years later. Among a few successful foreign investment projects it is possible to name only the Finnish Helkama Forste Viipuri Company producing refrigerators and the Svetogorsk pulp-and-paper mill, acquired by the American International Paper Company.<sup>26</sup>

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<sup>26</sup> Until 1997 Svetogorsk was part of the Vyborg municipality, but then it has obtained the status of an independent municipality. Its population is about 15.1 thousand. It is situated on the Finnish-Russian border, close to the Finnish town of Imatra. According to local observers, Svetogorsk has been separated from Vyborg in order to free it from negative influences of the Vyborg Administration,

Like in Sortavala, in Vyborg a notable role has been played by the EU's Tacis Programme, which has invested in construction of a number border-crossing points, as well as in some other public-sector projects. Nonetheless, in general it can be said that foreign investors have avoided Vyborg, even despite the relatively good investment climate in the Leningrad region.

Beyond Vyborg and Sortavala, successful FDI projects in border municipalities have also been rare. Perhaps, the only notable success is the project of Finnish PKC Group, which has invested two million euros in its Karelian venture, Karkhakos Company. This company produces electric equipment for Volvo and Scania trucks and buses, as well as for Finnish firms Nokia and Wacon. This company is situated in the town of Kostamuksha, to the North from Sortavala. In 2003 PKC Group intends to expand the Karkhakos factory in order to conclude new contracts with French Renault and Japanese Komatsu. As a result, the number of its employees should increase from 400 to 1000. The Karelian Government has even promised to provide some tax breaks to this venture.<sup>27</sup>

In contrast to the so modest volume of foreign investments in border municipalities, Russian domestic investments in Vyborg and Sortavala have been much more substantial. Thus, in Sortavala domestic investments have been made mainly in timber-logging, wood-working and in retail trade serving cross-border tourist flows. The leading Sortavala's industrial enterprise, the Värtsilä Metal Plant, has been acquired by the Mechel Group from Chelyabinsk. In 2002 this plant increased its output threefold.<sup>28</sup>

Large-scale investments have been made on the Valaam Archipelago – in reconstruction of the historical Valaam Monastery and in improving local infrastructure serving pilgrims, tourists and Valaam's residents. The Russian Government has recently approved a special federal programme providing financial and non-financial assistance to reconstruction of the Monastery. Additional funding has been provided by the Valaam Pilgrimage Company, owned by the Monastery, as well as by numerous private sponsors. It is planned to turn Valaam into a major Russian ideological centre popularising Orthodox Christian values in Northwest Russia and beyond.

In Vyborg domestic investments have been made in the traditional sectors, such as timber exports, retailing and catering. However, the most substantial projects have been carried out in the field of transport infrastructure: construction of the Primorsk seaport (to the South from Vyborg) and a new oil pipeline linking the port with existing network of Russian oil pipelines.<sup>29</sup> It should be noted that throughout the 1990s Russia's strategy in this field aimed at securing 'transport independence', which means the ability to export Russian goods directly to the West, without relying on services of such intermediaries as the Baltic states and Finland. In practice, this has

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which hampered Svetogorsk's economic development in the early 1990s (Independent Press: 16 June 2000, [http://www.pres.ru/cgi-bin/show\\_onetext.pl?Inc=62&offset=100](http://www.pres.ru/cgi-bin/show_onetext.pl?Inc=62&offset=100)).

<sup>27</sup> Potashev, Valeriy (2003), 'Eshche bol'she elektroprovodki', *Ekspert Severo-Zapad*, 31 March: 12.

<sup>28</sup> The report on Karelian economy in 2002, available at <http://www.hkkk.fi/ecomon>

<sup>29</sup> In Russia this project is known under the name: Baltic Pipeline System.

led to construction of two new seaports: Primorsk and Ust'-Luga.<sup>30</sup> These ports allow Russian companies to substantially reduce their transportation costs. Thus, the cost of transporting oil via Primorsk is \$3-4 per ton lower than through the alternative Ventspils port in Latvia.<sup>31</sup> Moreover, the Russian Government has stimulated the use of the new Russian ports by reducing rail transportation tariffs for goods exported from these ports.

At the initial stage of the Primorsk project it was planned to obtain partial funding from the European Bank for Reconstruction and Development (EBRD). However, the bank was ready to provide a loan only if the pipeline is extended to the Finnish port of Porvoo, thus making Porvoo a direct competitor for Primorsk.<sup>32</sup> This proposition has been declined, and the Primorsk project has been implemented on account of Russian money only (mostly the federal budget and OAO Transneft' – a public company responsible for managing Russia's pipeline network). The total amount of investments was US\$ 500 million. Now the Russian Government intends to begin the second stage of the project in order to increase Primorsk's oil transportation from the present 12 million tons per year to 30 million by 2005. As a result, shipments of Russian oil through the Baltic states and Finland will be decreased accordingly.<sup>33</sup> A number of large Russian oil companies also intend to build an oil refinery in Primorsk. Two competing projects are being considered now.<sup>34</sup>

Another major recipient of domestic investments in the Vyborg municipality is the Vysotsk seaport. AO LUKoil, the second largest Russian oil company, has begun to build an oil terminal in this port at an estimated cost of US\$ 300 million. It is designed to transport 10.75 million tons of oil and oil products annually. From Vysotsk Russian oil products will be shipped mainly to the USA where LUKoil owns a network of petrol stations.<sup>35</sup>

RAO Gazprom, the Russian monopoly producing and supplying natural gas, has recently launched a major transportation project together with the Finnish company Fortum. This project has been titled North European Gas Pipeline. The new pipeline will be supplying natural gas from the Russian North, via Vyborg, to Finland, Sweden, Denmark, Germany and the UK.<sup>36</sup> A major part of the pipeline will be laid on the bottom of the Baltic Sea. By constructing this pipeline Gazprom desires to deliver natural gas directly to Western Europe, while at present its pipelines go through the territories of other countries, which is less efficient economically. It is planned to complete construction of the pipeline by 2007. The total estimated cost of the project as a whole is US\$ 5.7 billion. In the Vyborg municipality Gazprom intends to construct a gas compressing station in the Portovaya Bay.<sup>37</sup>

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<sup>30</sup> The latter port is situated on the Southern shore of the Gulf of Finland, in the Kingisepp municipality of the Leningrad province. A number of other port-related projects are also under consideration now.

<sup>31</sup> Ershov, Andrei (2000), 'Primorsk stal razmennoi monetoi', Delovoi Petersburg, 24 April: 5.

<sup>32</sup> Romanyuk, Roman (2000), 'Fortum ishchet svoe mesto v proekte BTS', Delovoi Petersburg, 7 August: 3.

<sup>33</sup> Usmanova, El'vi (2002), 'BTS budet rasti do 2005 goda', Delovoi Petersburg, 2 September: 38-39.

<sup>34</sup> Vil'de, Tat'yana (2003), 'Neftyaniki delyat mesto v Primorske', Delovoi Petersburg, 4 March: 3.

<sup>35</sup> Ershov, Andrey (2003), 'Aleksperov posluchaet obshchestvennost', Delovoi Petersburg, 17 January: 3.

<sup>36</sup> In addition, natural gas will be delivered to the Kaliningrad region of Russia.

<sup>37</sup> Ershov, Andrey (2002), 'Lenoblast' poluchila milliardnyi proekt', Delovoi Petersburg, 22 November: 3.



Finally, a major project in the Vyborg municipality could be realised by the Finnish state. Finland rents the Russian part of the Saimaa channel linking the Finnish Saimaa lake with the Gulf of Finland. The lease agreement was concluded in 1963 for 50 years. Now Russia and Finland begin talks about concluding a new agreement for another 50 years, starting from 2013. If such an agreement is concluded then Finland intends to substantially upgrade the channel. For instance, it is planned to make it operational all year round, while at present it is closed during the winter season. The estimated cost of this project is about 170 million euros.<sup>38</sup> The channel functions as a major transport artery linking Finland and Russia. In 2001 its cargo turnover grew to two million tons. Finnish Stora Enso Company transporting timber products has been the main commercial user of the channel. In addition, about 100 thousand Finnish tourists visit Vyborg via the channel each year.<sup>39</sup>

In sum, it is possible to observe a peculiar pattern. Small-scale projects in traditional economic sectors in border municipalities are realised mainly on account of Russian private investments. Large-scale projects are implemented on account of Russia's largest corporations supported by the Federal Government. Foreign private companies do not hurry to invest in border municipalities. Their involvement is limited only to small-scale subcontracting projects.

This situation can be explained as follows. At the small-scale level business opportunities are monopolised by local insiders for whom personal control over local resources is more important than economic development of the municipality as a whole. This is quite common for Russia in general, but it seems that in border municipalities it is particularly so. Under present circumstances (i.e. the substantial gap in personal incomes in Finland and Russia), openness of the border stimulates cross-border illegal or semi-legal ventures, which immediately fall under full control of well-organised criminal gangs. The possibility of fast enrichment in border municipalities strengthens criminal organisations in such locations. Thus, reportedly, in Vyborg the business community is controlled by a group of former sportsmen who turned into a gang providing 'security' services to all more-or-less important enterprises. They have even penetrated the municipal administration and forced it to privatise municipal properties at a fraction of their market price.<sup>40</sup>

Border mentality has also been greatly influenced by patriotic beliefs represented by military and security personnel abundant in border municipalities. The influence of these people in border municipalities cannot be overestimated. They control substantial federal financial resources and play an important role in local politics. More importantly, their mission – to defend Russia – is projected to the border society as a whole and becomes the prevailing attitude of the local populace. In this environment foreign investors are perceived as an unwelcome threat. In addition, for the Finnish-Russian case the historical legacy is also very important. Before WWII both Vyborg and Sortavala belonged to Finland, and now large-scale Finnish investments in these municipalities could be perceived in Russia as an attempt to return these areas.

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<sup>38</sup> Sholmov, Konstantin (2001), 'Finlyandiya podogreet kanal', *Delovoi Petersburg*, 20 February: 6.

<sup>39</sup> Greenex, 'Saimensky kanal dlya finnov ostanetsya bezvizovym', 5<sup>th</sup> March 2002, available at <http://www.greenex.ru/resource.html?type=1&id=29681>.

<sup>40</sup> Kochnov, Vyacheslav (2000), 'Golova i mozg vyborgskogo spruta', *Novosti Leningradskoi Oblasti*, 28 June: 4.

But there is also another side of this coin. Border municipalities are better known for prospective Western investors than off-border locations. However, this knowledge is mostly of negative character. As a result, foreign investors regard border municipalities as more problematic places and prefer to locate their Russian enterprises farther from the border.

At the large-scale level the Russian Federation uses the border municipalities for realisation of its mega-project. The economic strategy is simple: Russia strives to achieve transport independence from East European countries (especially the Baltic states, Ukraine and Belorussia) in order (1) to reduce the costs of transportation of its oil and gas to Western markets and (2) to increase dependence of these countries on supplies of Russia's energy resources, which should stimulate economic and political re-integration amongst the states of the former Soviet Union. Having alternative routes for delivering energy resources to the West, Russia will be able to put its relations with the neighbouring countries on equal footing, as well as to influence their economies through Russian energy tariffs. This is the real purpose of developing the new seaports in the Leningrad province and the new gas pipeline of Gazprom.

In Sortavala the Russian mega-project realises its cultural dimension: to strengthen Russian ideological sovereignty by promoting Russian traditional values. It seems in Northwest Russia this role will be performed by the Valaam Monastery. In the 1990s Russia suffered a complete defeat in this field. The Western liberal consumerist ideology has conquered minds of a substantial part of the Russian society. Western mass culture threatens the very existence of Russia as a truly *Russian* state. However, as it was shown above, Russian traditional culture still finds its way to the hearts of the Russian elite.

#### **4. Conclusions**

Vyborg and Sortavala have become arenas of competition between the European and Russian mega-projects, which occurs at the national, regional and municipal levels and has at least three dimensions: political, economic and cultural. In this context the roles of Vyborg and Sortavala are different. Vyborg is set to secure Russia's transportation independence, while Sortavala develops as a major spiritual centre projecting Russia's traditional values to the Russian Northwest and beyond.

The economic crisis of the last decade has stimulated re-orientation of Northwest Russia from domestic to foreign markets. Export of natural resources has integrated North-western regional economies with the EU. Reliance on exports was the only possible survival strategy amidst the Russian turmoil of the 1990s. Now export of natural resources becomes part of Russia's new geo-economic project: export earnings are to be used to finance internationally competitive Russian high-tech industries. The main political aim is Russia's re-integration with countries of the former Soviet Union, particularly Ukraine and Belorussia. These are the core ideas of Russia's present development strategy in which Vyborg and Sortavala play their above-mentioned roles.

Russian federal and regional authorities demonstrate duality in their approaches to cross-border contacts. This duality testifies that the Russian elite is divided into agents of pro-European integration subordinating Russia to the EU, and those dedicated to the independent Russian mega-project. This contradiction results in the persistent instability of the Finnish-Russian border regime and significantly affects development patterns of the border regions.

Finally, Russia's widespread corruption and insider bureaucratic monopolism can be conceptualised as a large-scale uncoordinated grass-root sabotage of the efforts to integrate Russia with the West. It is the subconscious defiance to foreign ideologies, the desire to retain indigenous control over local resources even if this hampers economic development. This resistance keeps Russia semi-isolated, but still sovereign and capable of playing an independent role on the global scale.

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