



# From Trade to Partnership

FINLAND'S ECONOMIC STRATEGY FOR RUSSIA

Editors

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Simon-Erik Ollus  
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## FOREWORD

Russia is the fastest growing market in the regions bordering Finland and the European Union, and the economic integration between Finland and Russia is expanding continuously. Therefore Russia is becoming more and more important for the development of business and competitiveness in Europe in the near future. Russia's unused potential for science, industry and services offers totally new business opportunities for companies. Foreign investors' interest in Russia is again reviving, but the lack of a realistic picture of the market is still an obstacle to the realization of projects.

There are several active players cooperating with Russia in Finland whose actions are often similar, even overlapping. These operations often have a one-time character, being fragmented in different parts in Finland due to the lack of consistent strategic definitions of policy, goals, and small amount of cooperation between organizations.

In the light of these factors, the Finnish National Fund for Research and Development (Sitra) decided in 2004 to take Russia as one of the focal areas in its operations. Sitra started a three-year Russia Programme in the beginning of 2005. This programme concentrates on creating a new kind of a framework for economic relations between Finland and Russia in different levels of influence. Implementation of the goals in the programme is done through its subprogrammes Strategy, Forum and Integration (more information at [www.sitra.fi](http://www.sitra.fi)).

Drafting Finland's economic strategy for Russia is one of the main goals set for the Russia Programme. It aims to define the vision for development of the economic relations between Finland and Russia in the medium-term timeframe and also to identify and outline strategic methods, modes of operation and measures needed to achieve the vision.

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Sitra invited 34 leading Finnish Russia experts from the public and private sectors to the drafting process of the economic strategy, and was responsible for the practical implementation of the strategy process. This report has been compiled from the results of the sessions of the strategy work group. The participants expressed a clear need to develop determinedly Finland's economic relations with Russia and to prioritize Russia's strategic value. They gave a valuable and strong visionary contribution in defining the strategic goals and measures and, as a result, many strategic measures are already being fulfilled in practice.

Sitra continues the work of its Russia Programme on strategic fields by compiling and coordinating work groups needed and by supervising the fulfilment of the strategic measures together with the responsible parties. In addition, Sitra has agreed to be responsible for certain development actions aimed at putting together a network consisting of participants and interest groups. Sitra also published the economic strategy in Russian to increase dialogue and cooperation with corresponding Russian organizations.

On behalf of Sitra's Russia Programme, I would like to thank all participants and the editors of this report for their excellent work on the development of economic relations between Finland and Russia. I hope that the results and proposals for action of this strategic plan will be met favourably by the readers and that they will be practical tools for them when considering the potential of Russia and deciding the practical action plans.

*Helsinki, 9th August 2005*

*Maaret Heiskari*

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## THE CURRENT STATE OF FINNISH-RUSSIAN ECONOMIC RELATIONS

Russia offers significant opportunities for the Finnish business sector. Finland's trade has grown rapidly in the 2000s and Russia is becoming Finland's most important trade partner.

Finland is an important thoroughfare to Russia and the volume of transit traffic is up to three times the Finnish exports to Russia. Transit traffic is an important source of revenue and jobs in Finland.

Thus far, Finnish companies have been cautious about their investments in Russia. However, the rapid economic growth in Russia is continuously creating new investment opportunities and presents great challenges, as well as opportunities, to Finnish know-how east of the border. Finland is the most popular travel destination for Russians within the EU, and Russian tourists leave a great deal of tourism revenue in Finland. Preserving and strengthening this position presents a challenge to Finland.

The economic integration between Finland and Russia has occurred almost by itself without any great public effort. However, determination in policy-making can help to integrate the economies of Finland and Russia even further.

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## A STRONG RUSSIAN ECONOMY IS IN THE BEST INTERESTS OF FINLAND

The national goal of Finland is to retain and develop the level of welfare already achieved. However, the preservation of welfare is not a given but is dependent on the success of the business sector and on economic growth.

According to the World Economic Forum, Finland is at present the most competitive country in the world and for now has coped reasonably well in the globalising and integrating world economy. Nonetheless, the Finnish economy is small and fragile. Therefore, we need to continuously seek new means to improve competitiveness, one of which is cooperation with Russia.

While the Russian economy is in a fairly good state, economic growth in the European Union is slowing down. This slow economic growth also means that, at least in the near future, the EU will not provide an impetus for the growth of the Finnish economy. At the moment, Russia is the most significant fast-growing market area, offering tempting new business opportunities to Finnish companies.

The continuing stability of the Russian economy is in the best interest of Finland. The Finns must not be afraid to seize the opportunities presented by Russia, and the consequent integration may well turn out to be the new driving force for Finnish economic growth. Hence, it is worthwhile to invest in Russia.

## THE RUSSIAN ECONOMY IS GETTING EVER STRONGER

Since the crisis of 1998, the development of the Russian economy has been favourable. The gross national product has grown on average by just over 6 per cent per year. The current rapid economic growth is largely due to the production of raw materials and the corresponding rise in their value, as well as the competitive edge created by the devaluation of the rouble in 1998. Growth is also evident in other fields of production, which consequently has a

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positive effect on the diversification of the economic structure of the country and increases prosperity in general.

The social importance of the economic growth can be perceived in, for example, the rapid growth in the consumption of goods. The purchasing power of all social groups has grown and the demand for Western services and goods is on the rise. Russia is aiming ever more emphatically to integrate into the world economy. In fact, it is in membership negotiations with the WTO and aims in various ways to promote the active participation of its business sector in the global economy.

Finland must not underestimate its own strengths in Russia. It has both traditional and recent experience of business activities in Russia. In recent years, there have been many success stories that support the perception of Russia's significant market potential.

Finland's position as Russia's neighbour clearly gives it a logistical and geographical competitive edge over its competitors. There is a long-standing tradition of cooperation between the authorities of the two countries, which is a prerequisite for effortless interaction. As a member of the EU, Finland is a part of the European Union and its economic zone, which also increases Russians' interest in the Finnish economy.

For many parts of Russia, Finland is geographically the closest foreign country serving as a link to the rest of Europe. Russians are already making substantial use of Finland as a gateway to Europe. In the logistics sector, valuable goods are transported to Russia through Finland. Furthermore, the Finnish attitude towards Russia is more neutral than that of many of the new EU Member States, which also presents a clear competitive edge.

In Russia, Finland has a reputation for being a reliable trade partner and a safe country. Finnish nationality is a positive factor when operating in Russia. The substantial number of Russian tourists serves as evidence of Finland's attraction as a travel destination in the Russian tourism markets.

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## FINNISH EXPERTISE

The market economy in Russia is in its infancy and is still developing. A switch from a planned economy to a market economy does not happen overnight in any country. Russia continues to be a nation with development trends that are difficult to predict and where uncertainties are great. At the same time, knowledge of the country's business environment, recognition of the risk factors and long-term commitment can engender significant results.

Finland has top-class expertise both in business activities and in several other fields in Russia. Finnish companies have had business relations with the Russians for a long time and know the culture and attitudes of their trade partners better than their European competitors. Likewise, the Russians are familiar with Finnish culture better than that of many other countries. Finland represents a pragmatic and adaptable culture that gets along well with Russia, and as a consequence the Finns have become experts on Russia. This expertise can provide Finland with a substantial international competitive edge in Russian markets.

Finland has special know-how on some of the central sectors in the contemporary economy. By taking advantage of this special know-how, Finland can develop into a leading expert on Russia at least when it comes to logistics, forestry, construction and technology. The high level of know-how in Finland also attracts Russians and other foreigners to Finland to specialise in these fields.

With the continuing economic growth, the demand for know-how on Russian markets will increase in Finland and abroad. Know-how on Russia is a competition factor, which should be capitalised on in the international markets. In that way, it can be harnessed to serve the needs of the business sector.

However, Finland must be more resolute in increasing know-how pertaining to Russia on all levels, from basic education to academic research. Finland cannot be the leading expert on all aspects of Russia but only in clearly specified fields. Specialisation in the development of Russia should be consistent and it should be visible in the educational system and research emphases.

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However, investments in Russia cannot become a reality without additional resources and support from society. Without adequately comprehensive basic know-how and a change in attitudes, Finland cannot become the leading expert on Russia. Furthermore, it is important to carefully consider how much resources Finnish society has, in other words, what Finland can invest in and what not. One thing is nonetheless clear: Finland cannot afford to take a back seat in the development of Russia.

## THE POTENTIAL OF ECONOMIC RELATIONS

The Finns have always had a special relationship with Russia. In the course of history, attitudes have varied but only seldom have they been unproblematic. Some Finns see Russia as a threat to be avoided, others see it as a challenging opportunity. However, old attitudes are rarely useful in an integrating and globalising world. The challenge for the Finns is to be aware of the current circumstances in Russia and to predict the future. Only then, can Finland take advantage of the opportunities that closer Finnish-Russian economic cooperation can offer.

With resolute policies, the economic integration between the two countries can accelerate and benefit both to a much greater degree than at present. By following measures in line with this strategy, the following goals can be achieved:

### **Russia is a driving force behind economic growth in Finland**

Finland benefits from the expansion of Finnish companies to Russia and the growth of business activities there. Finnish companies are active also in the wide-ranging Russian markets outside of Moscow and St. Petersburg. Many companies consider Russia as being an essential part of their business activities, and Finnish companies already actively participate in the production of services and in the establishment of

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industrial production in Russia. Russia is a driving force behind economic growth in Finland

### **The economic integration between Finland and Russia continues and accelerates**

The current, rather lively, economic cooperation is set to intensify even further and Russia will be consciously kept high on the Finnish agenda of economic policies. Finnish companies will invest in and integrate into the Russian economy much more than they currently do which will diversify Russian business life, create new exports and enhance the competitiveness of the country. Russian companies will also invest more in Finland. With the active backing of the Finnish business sector and the state, Russia is the single most significant economic partner of Finland.

### **Finland is the leading expert on Russia**

Finland is the leading foreign expert on Russia, and invests in the continuous development of this expertise in the strategic fields of its own choice, such as logistics, forestry, construction and technological industry. The high level of Finnish know-how pertaining to Russia attracts foreigners to Finland for specialisation and makes it easier for Russian companies to operate in Finland. The services based on the Finnish expertise on Russia are commercialised for international markets. Finland also attracts Russians as a country of education.

The Finnish political leaders and civil servants have managed the relationship with Russia quite well and part of the efficiency of the Finnish society lies in such well-functioning cooperation between administrative bodies. In matters related to Russia, the Finnish business sector and the authorities work in close cooperation.

Russia is becoming the most important trade partner of Finland. However, in political decision-making this development has not received the attention it deserves. Well-functioning economic relations require that Russia is consciously kept high on the Finnish agenda of foreign and economic policies. The responsibility for this rests primarily with the highest political administration.

### DELEGATION OF RESPONSIBILITY FOR RUSSIAN AFFAIRS IN THE GOVERNMENT

In the current government, Russian affairs belong mostly to the Minister for Foreign Affairs and the Minister for Foreign Trade and Development. As Russia is becoming Finland's most important trade partner and the economic integration expands, the associated political questions must be raised to the appropriate level. The main responsibility for economic relations between Finland and Russia rests with the Prime Minister. In addition, individual ministries should evaluate and intensify their cooperation with Russia.

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The government is committed to promoting the economic and political relations between Finland and Russia more resolutely than at present and to presenting the foci of interest in detail in the programme of the next government.

**Proposals for action**

- **Reinforce the responsibility of the Prime Minister and activate sector ministers in Russian affairs** (Government, political parties)
- **Introduce Russian affairs as a significant part of the new government programme** (Government, political parties)

## ACTIVATING POLITICIANS IN PROMOTING ECONOMIC RELATIONS

Today, only a few Finnish politicians talk about advancing Finnish-Russian economic relations, even though the economic integration between the countries is developing rapidly. The reason for the scarcity of interest seems to lie in attitudes and a lack of knowledge. All economic indicators show that Russia is going to become Finland's single most important trade partner, so the politicians should also examine their attitudes and enhance their expertise on matters pertaining to Russia.

Finland needs leaders with vision and expertise, leaders who are capable of advancing Finland's economic interests in Russia. Members of the business community are responsible for providing up-to-date information about Russia to political decision-makers but then the decision-makers themselves must also actively seek information.

**Proposals for action**

- **Finnish politicians are to take a more active role in promoting Finnish-Russian economic cooperation** (political parties, politicians)

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## ADMINISTRATIVE RESOURCES TO BE UTILISED MORE EFFECTIVELY

The Finnish authorities have good bilateral relations with Russia and some of the ministries manage them commendably. However, the relations are managed by various organisations at various levels. In addition, many provinces, regional councils and municipalities have strong connections of their own with the corresponding authorities in Russia. Hence, the Finnish cooperation network is simultaneously strong and fragile but for Russians it appears confusing.

Nevertheless, the Russian activities of the Finnish authorities are scattered and there is a great overlap especially in the work of various regions with their Russian counterparts. It is worthwhile to combine several projects into larger wholes, enabling better cooperation with Russian authorities. The aim is that Finnish participants communicate their Russian activities to each other in order to avoid overlap and to ensure the efficiency of the said activities.

The Joint Finnish-Russian Economic Council with its working groups also works as a cooperational structure and a forum for solving problems in bilateral industrial policies. On the Finnish side, the Council is headed by the Minister of Foreign Trade and Development and on the Russian side by the Minister of Economic Development and Trade. The Economic Council provides a prestigious forum for meeting political decision-makers in Russia and therefore its role is important in the active development of future relations. The relations engendered by the Economic Council to the respective administrative branches in Russia are unique when utilised appropriately, and provide the basis for further development of the work of the Economic Council. In the future, the recommendations by the Economic Council and its working groups must be utilised more effectively.

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### Proposals for action

- **The relationship between Finnish ministries and authorities in various sectors and their Russian counterparts at various levels of administration is to be made closer. In addition, coordination and exchange of information between different authorities and the business sector is to be increased considerably** (Economic Council, Ministry for Foreign Affairs, Ministry of Trade and Industry, Ministry of Transport and Communications, Ministry of Finance, National Board of Customs, Confederation of Finnish Industries, Central Chamber of Commerce).
- **The productivity of the cooperation with Russia in the public sector and the efficiency of its instruments are to be evaluated and developed** (Ministry for Foreign Affairs, Ministry of Finance).
- **Activities of the Economic Council are to be evaluated and, on the basis of this evaluation, its activities are to be developed** (Ministry for Foreign Affairs, Ministry of Trade and Industry, Confederation of Finnish Industries, Central Chamber of Commerce).

The European Union is the cornerstone of democracy, peaceful development, social progress and economic growth for the whole of Europe. Russia is an extremely important partner for the EU. Finland is exceptionally well placed to understand the needs of the Russian economy and can take advantage of this in developing the EU's relationship with Russia. It is important, for both Finland and the EU as a whole, that the economic integration between Russia and the rest of Europe takes place in a controlled manner. Finland should take a more spontaneous and active ownership of Russian policy development in the EU.

### FINLAND TO BE THE RUSSIA EXPERT IN EU

The European Union is the most important economic and political partner for Russia. Developing the EU's relationship with Russia must be a central aim of Finland's EU policy. Finland can raise its profile in the matter by making the development of EU-Russian relations a key issue of the agenda of Finland's EU Presidency in 2006.

When Finland takes advantage of its expertise on Russia in drafting the EU's Russian policy, it simultaneously attends to the economic and political interests of the EU and strengthens its own bilateral relationship with Russia. This approach also serves Russia's interests because Finland has a more balanced and complex understanding

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of Russia than many other countries in the union. The EU should become more active in economically and politically significant issues and should maintain a consistent policy regarding Russia.

The stronger role of Finland in developing the EU's relationship with Russia also means that Finnish experts on Russia should be encouraged to seek positions in the EU bureaucracy, Russia institutes and research institutes under the EU to develop and account for the relations between the EU and Russia.

The realisation of economic cooperation between the EU and Russia requires that organisations within the business community and corporate management take an active role in preparing the EU's Russian policy. The Finnish business sector could participate through EU-Russian cooperation forums and by preparing declarations.

#### **Proposals for action**

- **Finland is to make the development of the EU-Russian relationship the focal aim of its EU policy and take on an active role moulding the EU's Russian policies in a pragmatic direction** (Government, parliament).
- **Finnish experts on Russia are to be encouraged and supported in applying for positions responsible for Russian relations within the EU bureaucracy, as well as in the EU-governed institutes studying Russian affairs** (Government).
- **Organisations within the business community and business management are to actively take part in the activities of EU-Russian cooperation forums and in the preparation of declarations** (Confederation of Finnish Industries, Central Chamber of Commerce).

## **NORTHERN DIMENSION**

The Northern Dimension (ND) is Finland's initiative to develop the EU's foreign relations and regional cooperation in northern Europe. The Northern Dimension is clearly developing into an integral part of the regional cooperation between the EU and north-west Russia. The continuation of the ND is to be decided during Finland's EU Presidency in autumn 2006. Crucial issues for its continuation are

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Russia's strong commitment to the programme and the equal status of the partners. Russia needs significant investments in logistics and infrastructure, as well as in the ND partnership in these fields, which can build on the positive experiences gained from current environmental, social and health partnerships.

The significance of the regional cooperation in the northern part of the EU is going to grow now that the Baltic States and Poland have joined the Union. In the Baltic Sea region, there is a need to coordinate disjointed networks and intensify the economic cooperation of the operators with Russia in the fields of logistics, information technology and energy, to name but a few.

#### Proposals for action

- **Finland is to incorporate logistics and infrastructure partnerships in the next Northern Dimension programme** (Government, parliament).
- **Finland is to take an active role in coordinating the disjointed economic networks of the Baltic Sea region and sets it as a goal in the next Northern Dimension programme** (Government, parliament).

## ECONOMIC INTEGRATION BETWEEN THE EUROPEAN UNION AND RUSSIA

The expansion of the EU's cooperation with Russia and its pragmatism is in the best interests of both Finland and Russia. The cooperation between the EU and Russia should primarily be focused on strengthening economic liaisons. The ultimate goal should be an EU-Russian economic zone, which is based on a free-trade agreement and free entry to markets.

The birth of a common economic zone represents a significant step in integrating the economies of the EU and Russia since the business sectors of both parties benefit from free economic activity. A common economic zone will make it substantially easier for Russian companies to function in the internal markets of the EU and for EU companies in the Russian markets.

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A further requirement for the birth of a common economic zone is that the EU lobbies Russia to actively develop the operational preconditions of foreign companies in Russia. Among other things, Russia should improve the protection of investments, decrease bureaucracy and develop the legal system and legislation on proprietary rights. An important part of this process is Russia's membership in the WTO.

Another crucial issue in the creation of a common economic zone is the removal of obstacles to the functioning of the external border. The Finnish-Russian border is the best functioning of Russia's borders because its functionality has been consistently developed and, for example, electronic customs clearance has been tested on the border in order to facilitate the work of the border guard authorities and goods suppliers. Despite developing processes and new technical solutions on the border, malpractices and corruption are still commonplace.

The European Union, in conjunction with Russia, must promote the functioning of the border while simultaneously improving border surveillance. The long-term goal of the EU is a visa waiver programme with Russia because economic integration requires flexible border formalities. Finland must actively promote the fulfilment of the preconditions for removing visa restrictions as soon as possible. In the short term, the flexibility of visa regulations between Russia and the EU is to be increased; travelling between the countries is to be made easier through longer visa validity periods, easier obtainability of work permits and facilitation of border crossing for students and young people.

#### **Proposals for action**

- **The European Union is to strengthen its economic cooperation with Russia with the aim of creating a common economic zone (Government).**
- **The European Union is to proceed consistently towards removing visa restrictions between Russia and the EU and enhance the flexibility of border-crossing as soon as possible (Government).**

## Finland to become the foremost expert on Russia

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Finland has accumulated long-term experience and strong business know-how in Russia. In addition, Finland has become a specialist on some of the key sectors in the current economy. By combining its Russia expertise with the specialist know-how, Finland can achieve a leading position as a Russia expert in strategic fields such as logistics, forestry, construction and technology industry. Additional Russian business expertises can be found in the fields of energy and foodstuff industries.

The high level of know-how in Finland also attracts Russians and other foreigners to Finland to specialise in these fields. By investing in raising the level of know-how and taking advantage of accumulated experience, Finland can become an internationally attractive educator in these fields.

### STRONG FINNISH BUSINESS KNOW-HOW

Finland has a long experience in working in Russia, and thus has accumulated strong business know-how, amongst other things, in jurisprudence, process management and project management. Finland's advanced knowledge of the business environment gives it a competitive edge.

As the level of Russia's own know-how and the extent of added value rises, the competitive edge of a foreign operator must be based on quality and competence. Managing local business models and

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risks can be precisely what separates the Finns from other foreign competitors. The business know-how pertaining to Russia must remain high if Finnish companies wish to retain their position and grow in the rapidly evolving Russian markets.

## FINNISH LOGISTICAL EXPERTISE

Finnish logistical expertise is a result of long and determined work. Close cooperation with the authorities and logistics entrepreneurs has been significant for the development of the field.

Finland's position as an important country of transit to Russia is based on the rapidly growing Russian foreign trade and inadequate logistics system. Thus far, the situation is favourable to Finland because it increases the demand for Finnish expertise and services in Russia. Finland's position as a transit country may, however, change in the long run, as Russia aspires to become logistically more self-sufficient and the transport network through the Baltic States is improved. The development sets new challenges for Finnish logistics expertise and services.

Finnish companies participate actively in projects dealing with Russian logistics infrastructure and are becoming a part of the Russian logistics network. In order to achieve its goal, Finland must continue to develop the cooperation with the authorities, support the logistics know-how of Finnish companies in Russia, and tempt Russians to study and specialise in logistics in Finland. The aim is to utilise Finnish logistics expertise in line with the interests of both countries.

## FINNISH WOOD AND PAPER EXPERTISE

Finland has a significant forestry competence cluster. Finland is already utilising Russia as a source of raw wood but the future potential is substantially greater. The Russian forestry sector is growing slowly and it is only a question of time before the investment atmosphere in Russia improves to such a degree that wood processing and paper manufacture are moved closer to the raw materials.

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The large forestry investments are still waiting for the completion of Russian forest legislation. It seems likely that companies will not invest in large processing plants before it is completed. The cooperation between Russian and Finnish authorities and taking advantage of Finnish experiences have been important in the preparation of the legislation. The Finns have substantial opportunities to raise the competitiveness of Russian forestry and the forest industry by, for example, realising joint development projects on logistics and forestry.

Finland possesses know-how on the entire value chain of the forest industry and knowledge about the functioning of the field in Russia. There is a great deal of demand for Finnish forestry expertise, which can be substantially utilised in Russian projects.

## CONSTRUCTION EXPERTISE

Finnish companies have extensive experience of construction work in Russia. The pioneering companies of Finnish trade to Russia evolved from the building trade, and this industry has accumulated valuable know-how over the years. In addition, several small and medium-sized enterprises (SMEs) have gone to Russia as subcontractors in the wake of construction companies. Nowadays, subcontracting is offered also by many Russian companies and companies founded in Russia by the Finns.

Financing is the greatest source of worry for Finnish construction companies in Russia. Financing is usually taken care of through cash flow, which is a great impediment to growth. The underdevelopment of financing and collateral security practices is a problem especially for the development of dwellings, in which Finnish companies have comprehensive know-how and in which the market prospects are promising.

Finnish construction materials have a good reputation in Russia and they are considered to be of good quality and suitable for the local climate. Consumers appreciate the technical solutions and the know-how applied by Finnish companies.

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Construction is one of the fastest growing branches of industry in Russia and it also provides significant opportunities for Finnish service companies in building and real-estate branches, as well as training and research institutes in the field.

## TECHNOLOGY EXPERTISE

Russia aims at raising the level of its information and communication technological (ICT) know-how and at building an information society. Simultaneously, Russia feels the limits of its own technology and understands that improving competitiveness requires considerable investments in technology and raising the extent of added value. The Russian government is aware that increasing the utilisation rate of information technology is a necessary condition for diversification of the economy and the development of many basic services, such as the health and social sectors, education, and security. Russia is also willing to invest in increasing the export of its own technology industry and the development concept for the sector draws from the successful export models of other countries in the field of ICT. An attempt has been made to develop the technology industry, for example, by venture capital for technology and innovations provided by the state, and by investing heavily in the science and technology park concept.

The demand for technology in Russia is growing and Finland can offer high-quality information technology and expertise in other kinds of high technology, even though the markets for these are still in their infancy in Russia. When the high level of technological expertise in Finland and the increasing demand in Russia are combined, both countries stand to benefit from cooperation.

At the moment, only a few Finnish technology companies carry out development work in Russia and participate in Russian information technology projects. In order for the Finnish companies to be involved in the development of the Russian information society, the cooperation between Finnish and Russian administrations needs to be greatly increased. The central precondition for having small

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Finnish technology companies participate in the cooperation is to develop a network providing reliable and good contacts for collaborations.

The Finnish universities and research institutes in the field of technology are to be urged into specialising as top experts in Russia in their field and all the operators in the field are to be encouraged to undertake closer cooperation with their Russian counterparts. The aim is to achieve a position of being an attractive cooperation partner and training place for Russian experts in ICT and technology. The attractiveness of Finland can easily be increased by coordinated specialisation and distribution of work between universities and research institutes.

## CORE COMPETENCE AREAS OF FINLAND

Finland aims at being the market leader in those strategically important fields in which the Finns possess special expertise. To achieve or to uphold this position, the cooperation on research and development and the financing of these fields must be significantly increased. Research institutes must be encouraged to specialise as the leading experts in their fields of study. The same goes for education, where the same kind of education on basic business skills is offered by almost all the universities at the moment, but where only a few schools offer deeper specialisation in various fields of business in Russia. The basic business training in Russia needs to be organised through cooperation networks while supporting the joint specialisation of universities. This would help strengthen the Finnish education network and greatly enhance Finland's attractiveness as a country of education.

The development of cooperation based on innovations creates an altogether new business potential between Finnish and Russian operators. Russia has a great deal of know-how and universities specialised in certain narrow fields. These resources are to be utilised by jointly developing know-how and new products for the global marketplace.

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Functioning cooperation with the Russian administration is vital, which, for its part, has supported companies in developing their Russian business activities. For this reason, strengthening cooperation is a central precondition for the improvement of Finnish-Russian know-how and the recognition of the future needs of Russian industry, as well as predicting the economic development.

In addition to bilateral relationships between the authorities and research institutes, the Finnish-Russian commission on scientific and technological cooperation works as a cooperation body for the fields of science and technology.

Strategically important fields must also be included in the Finnish-Russian political agenda. Cooperation must be deepened by forming partnerships in those fields of expertise that are strategically important to Finland. Field-specific research institutes, unions and academies should be invited to supplement the authorities in cooperation bodies. The current intergovernmental agreements are to be amended with the focus on agreements supporting concrete cooperation with Russia in the fields of research, education and innovation.

Russia is preparing to found industry and technology parks to support the diversification of industry, structural modernisation and the creation of large industry clusters. Finland is in possession of strong technological know-how and many large Finnish companies have experience from developing similar projects, which could also be utilised in Russia. Industry and technology parks in Russia could provide many Finnish companies with an excellent opportunity and environment to commence research work or production. In the initial stages, the Finnish government could take an active role and participate in developing these projects especially in regions near Finland.

In addition to developing technology parks, an attempt is to be made to utilise Russia's innovation know-how more comprehensively. The Russian policy on innovations is largely based on input by state research institutes, and the key issue is how to give rise to new enterprises to commercialise the results of this work. The high-level expertise of both countries could be utilised, and a new

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dynamic cooperation potential identified both in administration and business sectors, by founding, for example, a Finnish-Russian innovation centre. At the same time, Russia would have a chance to familiarise itself with the Finnish private and public sectors, or even try out cooperative models in the sectors.

#### **Proposals for action**

- **Finland is to aim at reaching a partnership agreement with Russia in central fields of expertise** (Government, parliament).
- **Additional funding is to be directed at education, research and R&D in Russia in those fields of expertise that are central to Finland** (Ministry of Trade and Industry, Ministry of Labour, Ministry of Transport and Communications, Ministry of Finance, Ministry of Agriculture and Forestry, Ministry of Education, National Technology Agency of Finland (TEKES)).
- **The interaction between Finnish ministries, companies and universities and their Russian counterparts is to be enhanced in order to develop research and innovation** (Government, universities, polytechnics, Confederation of Finnish Industries, Central Chambers of Commerce).
- **Universities and research institutes are to specialise in a coordinated manner as top experts in their respective fields** (Ministry of Education, universities, polytechnics, research institutes, Academy of Finland).
- **The possibility of studying central fields of expertise in Finland is to be marketed to Russians** (Ministry of Education, universities, polytechnics).
- **An assessment of the scientific and technological cooperation is to be performed on the basis of which activities are to be developed** (Ministry for Foreign Affairs, Ministry of Education, Academy of Finland).
- **Participate in the development of Russian industry and technology parks especially in Finland's neighbouring areas** (Ministry of Trade and Industry, Ministry of Labour, National Technology Agency of Finland (TEKES), Sitra).
- **Finnish-Russian cooperation in innovation is to be promoted by founding a joint innovation centre** (Ministry of Trade and Industry, Ministry of Labour, Ministry of Education, National Technology Agency of Finland (TEKES), Confederation of Finnish Industries, Finnvera, Sitra).

Finnish high-quality expertise on Russia serves, in particular, the Finnish business sector but Finland should also be able to sell this knowledge abroad. The current supply of commercial expert services on Russia is fragmented, the consulting firms in the field are almost without exception small and most of them are not known internationally. With the growth of the Russian economy, the demand for expert and consulting services increases both in Finland and abroad. Russia know-how is a competition factor that Finland should exploit and develop.

### MARKETING AND DEVELOPING CURRENT SERVICES

A company working in Russia, or planning to do so, needs reliable information about the local conditions. The company needs information on risk analysis, location, recruiting opportunities, market research, analysis of competitive situation and legal services. The operation of newcomers to Russia is fraught with risks that have mainly to do with weak market knowledge and management of the business environment. The entrepreneur must recognise these risks and this can only happen with expert help.

In Finland, these services are offered by the public sector, organisations dealing with export promotion and internationalisation receiving public funding, and private consultants. In addition, a

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number of research institutes provide information about the Russian economy for free. Information is available but it is difficult for a company – especially an SME – to know which source to turn to and what information to seek.

Current expert services and information sources need to network more closely, specialise and deepen their core competences. With the help of a cooperation network, better expert services can be developed, which the service providers can also market abroad together.

Many Finnish SMEs have encountered difficulties in Russia with such issues as the bureaucracy of local government. Therefore, the information needs of SMEs are directed especially at business information on the conditions in Russia and the development issues at local level. The familiarity with local conditions is especially important when the company is starting up production in Russia.

The majority of the Finnish public sector and export promotion organisations are located in the Moscow and St. Petersburg regions, which means that those are the regions with which they are most familiar. The business potential of other regions in Russia is growing all the time and Finnish entrepreneurs must be encouraged to move also into these new markets. In these regions, there is still only very little competition and the growth potential for business is thus greater. Finnish export promoters should, as part of their service range, publicise the opportunities presented by these regions more forcefully than they do at present.

Employment and Economic Development Centres have a crucial role in dispensing this knowledge to companies. Currently, only the Employment and Economic Development Centre for Southeastern Finland is specialised in providing services relating to Russia, and that is where the other centres refer their clients that are interested in Russia. All the Employment and Economic Development Centres in Finland should have basic information on Russia and Finnish expert service providers so that they could guide companies interested in Russian markets to the correct service provider more effectively and more rapidly than at present. Export promotion know-how of

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the Employment and Economic Development Centres can be enhanced by increasing their experts' training on Russian affairs.

The Russia know-how and research in Finland are of high quality. By developing the cooperation across the respective areas of expertise of the current service providers, a significant and internationally renowned provider of expert services on Russia can be created. Development and commercialisation of the expert know-how can be a new growth area for Finland. The Finnish expert service providers must revise their current operating models and collaboration opportunities and research the possibilities of commercialising their services internationally.

#### Proposals for action

- **Improve the public sector and expert services receiving public funding by specialisation and increased networking** (Finpro, Finnish-Russian Chamber of Commerce, Finnvera, Employment and Economic Development Centres, consulting firms).
- **Promote more strongly the niche marketing efforts of the Finnish business sector in Russia while taking into account regional differences** (Finpro, Finnish-Russian Chamber of Commerce, consulting firms, Confederation of Finnish Industries).
- **Finnish participants to collaborate in order to develop a functioning support network for companies going to Russia and for those already working there** (Ministry of Trade and Industry, Ministry of Transport and Communications, Ministry for Foreign Affairs, Finnish-Russian Chamber of Commerce, Central Chamber of Commerce, companies).
- **Train the export representatives of the Employment and Economic Development Centres in the basics of Russian business and giving["give"?] them an information package on the providers of expert services** (Ministry of Trade and Industry, Ministry of Labour, Employment and Economic Development Centres).
- **Map out the possibilities of forming an internationally significant provider of expert services on Russia working according to commercial principles** (Sitra).

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## COMPETITIVE FINANCING AND A CREDIT SYSTEM ARE STILL IMPORTANT

A competitive export credit system is important to companies and, especially in large-scale projects, finance guarantee confers a significant competitive edge. The Finnish public export subsidy system must remain competitive when compared to all central competitors; otherwise Finland will lose its position in Russia. Finnvera is the central operator in the field and its task is to offer and develop export subsidies in accordance with the needs of the market.

The key issue for SMEs is how to bear the business risk of operating in Russia. When the share of the Russian activities in the turnover rises to a dominant position in an SME, a sudden swing in the Russian economy or changes in border regulations can overnight present the company with insurmountable difficulties. In addition to export credits, a further change and crisis situation guarantee system could be developed.

At the moment, only Finnfund handles publicly funded capital investments in Finnish companies aiming at Russian markets. Because of its operating principle (development cooperation), it has recently ruled Moscow and St. Petersburg out of its operational area and further emphasised the developmental aspect of its financing. For these reasons, there is a funding deficit, which needs to be analysed in detail. An alternative is to develop a new SME-focused Russia fund for capital investments of, for example, less than three million euro.

### Proposals for action

- **Increase information about financing opportunities for SMEs and assess the competitiveness of export credits** (Finnvera, Finpro, Finnish-Russian Chamber of Commerce, Employment and Economic Development Centres).
- **Investigate the need for a Russia fund focused on funding SME projects** (Ministry for Foreign Affairs, Ministry of Trade and Industry, Finnfund, Finnvera, Sitra).

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## INVESTMENTS BY RUSSIAN COMPANIES IN FINLAND

There are plenty of internationalisation services for Finnish companies aiming at Russian markets, but, apart from Invest in Finland, no one actively promotes the entry of Russian companies into Finnish markets. The Trade Representation of the Russian Federation uses its own methods to promote the import of Russian goods to Finland.

The Finnish providers of internationalisation services are able to operate much more bidirectionally and visibly in Russia. Furthermore, many of them know the kind of needs that Russian companies have, and have offices in Russia, which provides them with the preconditions for a comprehensive range of services. The aim is to promote bilateral trade and investments in a more centralised, coordinated and efficient manner. This requires that the current service providers revise their range of services and seek synergy by increasing collaboration with each other.

### Proposals for action

- **Develop current expert services to also serve Russian companies** (Invest in Finland, Finnish-Russian Chamber of Commerce, Ministry of Trade and Industry, Employment and Economic Development Centres, Central Chamber of Commerce).
- **Promote investments in Finland by Russian companies** (Invest in Finland, Ministry of Trade and Industry, Finnish-Russian Chamber of Commerce, Employment and Economic Development Centres, Central Chamber of Commerce).

Retaining and developing the high level of Finnish expertise on Russia will require investments in high-quality research on Russia. Research on Russia is mostly funded by the Ministry of Education and the Academy of Finland. Additional support is provided through project funding and activities of the Ministry of Trade and Industry, the Ministry of Transport and Communications, the Ministry of Agriculture and Forestry, the Bank of Finland, the National Technology Agency of Finland (TEKES) and of the business and industry sectors. Despite the number of investors, the basic funding is insufficient and the projects are short-lived. Some research institutes seek additional funding in the form of various EU subsidies, which usually are directed primarily at applied research or practical surveys. Coming up with the proportion of internal financing has often proved difficult for research institutes funded out of the government's budget.

An increasing amount of internal financing is demanded from the research institutes and the competition for research funds is getting stiffer. If Finland wishes to be characterised as a leading expert on Russia, both existing financing systems and their points of overlap must be re-evaluated. Furthermore, attention must be paid to adequate basic funding, international cooperation must be increased, the indicators of Finnish research investments must be revised and current trends in public research funding must be evaluated critically.

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## MAKING RESEARCH MORE EFFECTIVE BY CENTRALISING EXPERTISE AND REMOVING OVERLAP

Cooperation between research institutes and investors must be developed, and it should be persistent and the basic funding adequate. The criterion for receipt of resources for applied research cannot be solely the number of doctoral theses – the indicators should be significantly more pragmatic.

The investors should commit to a research institute for longer periods of time to allow the institute and the researchers to accumulate expertise, which leads to improved quality. Furthermore, the level of resources directed at research should be reviewed and research should be more focused on the output. The research on Russia should be of good quality and the research topics relevant from the point of view of society and business. Research institutes must be encouraged to collaborate, to employ a clear division of labour and to use resources effectively.

Because reaching the position of the leading expert on Russia also demands internationally high-quality academic research, Finland must take a more active role in the development of Russia's international research networks, while the investors should create national prerequisites for this. Raising the bar requires more Russia-related professorships in universities so that the level of Russia expertise in universities is raised. The business sector must also take part in founding new professorships on Russian studies and in determining their job description.

Environmental projects in the neighbouring regions, such as the southwest sewage treatment plant in St. Petersburg, have received international capital and loans through the environmental partnership programme of the Northern Dimension using the initial investment by Finland as a springboard. A similar model can also be applied in the field of research funding, but with an increased Finnish investment and responsibility. By intensifying the spread of information concerning EU funding and other international parties and by developing national funding channels to cover the propor-

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tions of internal funding, international funding for Finnish research on Russia can be substantially increased.

#### Proposals for action

- **Research on Russia in the Finnish research institutes is to be made more effective by centralising expertise and removing overlap** (research institutes).
- **Investors are to steer the specialisation of the research institutes and commit to long-term and purposeful financing** (Ministry of Education, Ministry of Trade and Industry, Academy of Finland).
- **Adequate numbers of professorships on Russian society, economy and culture are to be secured** (Ministry of Education, Academy of Finland, universities, Confederation of Finnish Industries).
- **Adequate basic resources are to be secured for academic and applied research on Russia** (Ministry of Education, Academy of Finland).
- **Obtain international research funding for Finnish research on Russia** (Ministry of Education, Ministry of Trade and Industry).

## APPLIED RESEARCH TO SERVE THE NEEDS OF THE BUSINESS SECTOR

There is currently a great deal of research carried out in Finland pertaining to Russia in the fields of business and commerce but the research is fragmented and cooperation between researchers is negligible. It is questionable whether the applied research serves the needs of the business sector effectively. The high level of Finnish expertise on Russia must be directed through this channel to serve the needs of the business sector, and it must also be commercialised internationally. Current research projects should be revised and applied research should be focused more effectively.

At the same time, representatives of the business sector are to be invited to take part in funding research, which means that investments can be increased and targeting of funds improved. Cooperation in research and knowledge work should take into account

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the needs of SMEs. Finnish SMEs need information for charting risks and recognising new business opportunities. Cooperation in research and knowledge work must be centralised both in the recognition of the opportunities in the general Russian business environment and in those branches of industry that are significant to Finland.

Finland has over 30 Russia-related research and information portals of varying quality. However, a great deal of knowledge and research on Russia exists and organising it rationally and into a user-friendly form is important for its effective utilisation. Several of the existing portals receive project funding, that is, their operation ends when the funding ends. These information portals must be brought together to create a common portal offering up-to-date information and reports on the circumstances in Russia. The portal would also include information on all recent Russia-related research and publications in Finland. The financing for the joint portal must be secured.

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### Proposals for action

- **The applied business research pertaining to Russia is to be targeted to better serve the needs of the Finnish business sector and entrepreneurs** (Ministry of Education, Ministry of Trade and Industry, Ministry of Transport and Communications, Ministry for Foreign Affairs, Confederation of Finnish Industries, Central Chamber of Commerce, research institutes).
- **The companies and especially SMEs are to be provided with information serving the business sector pertaining to the Russian economy and business environment** (Confederation of Finnish Industries, Central Chamber of Commerce, research institutes, Ministry of Trade and Industry, Ministry of Education, Finpro, Finnish-Russian Chamber of Commerce).
- **The companies are to participate in funding applied research** (Confederation of Finnish Industries, companies).
- **A financing group consisting of representatives of Finnish investors and research institutes is to be founded to coordinate the use of national funds for the internal funding proportion in international research projects** (Ministry of Education, Ministry of Trade and Industry, National Technology Agency of Finland (TEKES), research institutes).
- **The current research and information portals are to be combined into a common “Finland’s Russia Know-How” portal to which existing Finnish knowledge on Russia will be integrated and linked** (Ministry of Education, Ministry of Trade and Industry, Ministry of Transport and Communications, research institutes, Finnish-Russian Chamber of Commerce, Aleksanteri Institute).

## Raising the level of know-how regarding business in Russia

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Finland wants to succeed in the growing Russian markets, so the Finnish know-how pertaining to business in Russia must remain high. This requires that Finland should invest in developing know-how in companies, universities and polytechnics. In addition to knowledge of the Russian language, know-how on doing business in Russia is a prerequisite for succeeding there. Finnish business expertise in jurisprudence, international business, process and project management is highly regarded in Russia.

### RUSSIA OFFERS A CHALLENGING CAREER ALTERNATIVE

Russia presents a challenging career alternative for anyone planning on embarking on a commercial career. Unfortunately, a general lack of knowledge and Russia's poor public image weaken students' willingness to recognise these opportunities.

Companies need experts on trade, law, economics and technology who, in addition to their own fields, are familiar with the Russian business environment and have some knowledge of the language. In order for the students to better recognise the opportunities presented by Russia, the business sector must take a more active stance on marketing business education related to Russia and producing learning materials. Universities and polytechnics must be able to train experts in the fields of commerce and economics to respond

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to companies' growing demand for them in Russia as well as to motivate their students to choose this career alternative. The business sector can participate in marketing the Russian potential in Finnish universities and polytechnics specialised in commerce and technology through, for example, a joint road show. The business community's involvement in marketing the field should open the students' eyes to recognise the potential in the market area. More opportunities must be arranged for business management to contribute to developing teaching on Russia and to meet students in the field.

An 'economics incubator' based on existing university networks could be established to train Russia experts. The economics incubator could be a year-long programme for students nearing the end of their university studies. The incubator should mainly be directed at university undergraduates of commerce, law, economics and technology and by a flexible study rights agreement and through the Master's programme of the Aleksanteri Institute it should be open to students from all the universities. The investment on the part of the companies taking part in the incubator would be financially and time-wise insignificant but the companies would get a new recruiting channel for experts on Russian business life, for example, through practical training. The active involvement of the business sector and applied emphasis in the thesis work would significantly increase students' interest in the business incubator and the business opportunities in Russia. With systematic investments, the incubator may become an internationally significant provider of training services on Russian business.

Many Finnish universities and polytechnics offer a basic course in business know-how in the form of courses on "Doing Business in Russia". The quality and the extent of these courses vary from university to university. Teaching and specialisation between universities can be promoted by creating a joint basic course, which frees resources for specialisation. Basic training can be made more effective by developing a common structure to current courses. This would mean that a part of the course material and content would be common to all

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and available through the Internet. A common basic course enhances the quality of teaching and brings together different participants in a natural way. At the same time, the students will have a chance to acquaint themselves with the whole range of available studies.

There are more exchange positions available for Finnish university and polytechnic students in Russia than are currently used. A study year abroad is the best possible way to learn to know a foreign culture, country and its language. Finnish businesses should actively inform about their position in Russia and thereby motivate students to take part in student and trainee exchange programmes. Finnish university undergraduates are to be encouraged to spend an exchange year in Russia and get to know thoroughly the different regions of the country, so as to become acquainted on a practical level with the growing Russian markets and circumstances.

#### Proposals for action

- **Russia Road Show organised by Finnish businesses is to tour Finnish universities** (companies, Confederation of Finnish Industries, Central Chamber of Commerce).
- **The amount of teaching on Russian business activities in schools of economics and business is to be increased, the cooperation between providers of education services improved, and teaching resources are to be extended** (Ministry of Education, universities, polytechnics).
- **An 'economics incubator' is to be built on existing networks, especially for university undergraduates of commerce, law, economics and technology, to link applied research with the needs of business** (universities, Confederation of Finnish Industries, companies).
- **A partly web-based basic course package using current learning material pertaining to Russian business is to be created** (Ministry of Education, universities, polytechnics, Aleksanteri Institute).
- **Finnish students are to be encouraged to participate more in student and trainee exchange programmes with Russian universities and to take on practical training in regions further afield than St. Petersburg** (Ministry of Education, universities, polytechnics, companies).

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## ON-THE-JOB BUSINESS TRAINING

Many companies have a need to train their personnel and management further in questions related to the Russian business environment. There is little Russia-related on-the-job business training on offer in Finland. Finland lacks a provider of management training services specialised in business activities in Russia. Current MBA programmes are specialised in general business management but there is a need for a separate training focused on Russian business expertise.

The business know-how of the staff in companies operating in Russia must be developed by making the long-term marketing and export training in Russian business more effective. Development funding channelled through Employment and Economic Development Centres is available but, because of a lack of information, it is not fully utilised. Existing subsidies could be utilised much more efficiently, if the organisations of Finnish business and industry actively encouraged and informed their member companies about the opportunities.

### Proposals for action

- **A high-level centre of competence or enterprise institute providing training on Russian business know-how in Finland is to be created in collaboration with current networks of expertise** (Ministry of Education, universities, Confederation of Finnish Industries, Fintra, Sitra).
- **Organisations of business and industry are to encourage their member companies to provide on-the-job business training pertaining to Russia** (Confederation of Finnish Industries, Central Chamber of Commerce Ministry of Trade and Industry, Ministry of Labour, Employment and Economic Development Centres, Fintra, Finpro, Finnish-Russian Chamber of Commerce).

The image of Russia held by the Finns is the result of a long and eventful common history. Despite good efforts and intentions, it seems that the overall picture is still tainted by stereotypes. In the last two decades, Russia has gone through an enormous change but the Finns are not particularly familiar with present-day Russia.

In order for Finland to become a leading expert on Russia, the Finns have to understand events in Russia better than their competitors. This requires that the Russian realities are recognised and that they are taken seriously. It must also be understood what effect Russia has had, and continues to have, on the development of the Finnish economy and society.

The understanding of the rapid change in Russia and communicating the true circumstances presents great challenges to the school system and the media. It is important to provide children and young people at all stages of schooling with skills and knowledge so that they would have the prerequisites to understand the world as the challenging operational environment it is.

### BASIC KNOWLEDGE ABOUT RUSSIA

Without a comprehensive basic knowledge about Russia, the Finnish prejudices will not be lifted and Finland will not become the leading expert on Russia. Basic education pertaining to Russia must be carefully evaluated in order to raise public interest in Russia.

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The study of the Russian language in schools has slumped in the last ten years and, at present, only 1 per cent of the pupils in comprehensive schools study Russian. Less than 3 per cent of upper secondary school students graduate with a grade in either the short or long course in Russian. The aim is that the number of students studying Russian will multiply. In addition to the Russian language, the teaching of Russian culture, geography and history also needs to be increased. This would substantially improve the potential for the younger generations to operate successfully in Russia. At the same time, a foundation would be laid to raise the level of Finnish expertise on Russia internationally.

Finnish upper secondary school students have taken part in exchange programmes for over 60 years but student exchange to Russia is still almost non-existent. Previously, this possibility did not even exist but even though it is now available, the Finnish upper secondary school students have not seized it. Only about ten Russian exchange students a year come to Finland. Current student exchange systems have to be developed and their attractiveness increased, so that Finnish students would become interested in exchange studies in Russia. The attractiveness may be increased, for example, by emphasising the integration development of our economies and the career opportunities it presents. Russia has interesting cultural experiences and even exotic dimensions to offer. Current pupil exchange programmes with Russia are based on the initiative of individual participants. In order to increase the exchange, the educational administration must be more active in supporting and encouraging exchange programmes.

#### **Proposals for action**

- **The teaching of Russian language, culture, geography and history is to be increased in schools** (Ministry of Education, National Board of Education).
- **Student exchange between Finland and Russia is to be further encouraged** (Ministry of Education, National Board of Education).

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## BALANCED INFORMATION ABOUT RUSSIA

It is crucial for changing Finnish attitudes towards Russia that media reports on Russia are multi-faceted, factual and relevant. However, the responsibility for the correctness of the Finns' image of Russia cannot rest solely with the media; it is the joint responsibility of all social quarters.

There is still a great deal of fear and ignorance about Russia in the Finnish business sector. Overcoming such a fear requires correct and balanced information. The development of trade and the rapid growth of economic cooperation create a need for topical information. Without it many companies will miss the opportunities presented by Russia.

The interest of the Finnish media in Russia can be promoted with joint news conferences by the business sector and the government. Media houses can increase their follow-up on Russian events and procure Russia-related programming. Both the business and industry sectors have the potential to influence the matter, for example, through more active distribution of information on Russia. Their current bulletins on Russia could be distributed to all member companies, not just those already involved with Russia. The public sector can also increase information on its projects related to Russia, as they affect the development of the business environment.

At the moment, only a few Finnish companies systematically inform the Russian media of their projects in Russia. It is important that Finnish companies in Russia actively keep in touch with Finnish correspondents in Russia and pitch news items to them. The operational preconditions of the Finnish business sector in Russia could be promoted through a Moscow-based representation and representative jointly funded by business organisations. The representative would serve Finnish business by providing information on the Russian business environment and changes in it, and actively develop their operational preconditions. Additionally, the representative can build and maintain high-level contacts with Russian economic opinion leaders. The representative would also have the

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expertise to support the Ministry for Foreign Affairs in matters pertaining to Russian business life.

**Proposals for action**

- **Public and private sectors are to actively improve communication to the media on their operations pertaining to Russia** (Government, Confederation of Finnish Industries, Central Chamber of Commerce).
- **Examine the possibility of opening a joint representation for Finnish business and industry in Moscow** (Confederation of Finnish Industries, Central Chamber of Commerce, Ministry for Foreign Affairs).

## ON THE IMPORTANCE OF TOURISM

One of the best ways to change perceptions has always been travel. For Russians, Finland is one of the most tempting tourist destinations and the most popular one of the EU countries. Finland's position as a safe tourist destination has simultaneously improved Finland's overall image in Russia. Tourism provides significant income to the Finnish service industry. For Finland to retain this position requires that the Finnish travel industry and marketing are constantly developed.

However, tourism from Finland to Russia has not developed proportionately. Russia is considered a strange and even frightening country, even though Russia is Finland's neighbour and soon the most important trade partner. Moreover, it is often forgotten that when it comes to security, St. Petersburg and Moscow do not significantly differ from other major metropolises in the world.

**Proposals for action**

- **Bilateral tourism is to be developed to increase knowledge of Russia and Finland** (Finnish Tourist Board, Ministry of Trade and Industry, Ministry of Education, Ministry for Foreign Affairs).

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## SUPPORTING RUSSIA'S INTEREST IN FINLAND

Finland cannot be the leading expert on Russia unless the Russians are likewise interested in Finland and its know-how. Finland must actively market itself and its know-how in Russia and maintain close relationships with central Russian operators so that interest in Finland increases.

Finland can raise its profile as an expert on Russia, for example, by making the Russian decision-makers feel that Finland is a country that understands Russia's special characteristics. A high-level expertise can be exploited, for example, by regularly organising Finland's Russian Economic Forum, in which Russian economic and political decision-makers would participate with their international partners. At the same time, the Finnish counterparts would learn to better understand Russia and its needs.

The Forum would focus on central fields for Russia and Finland, and would function as an initiator of discussion. The topics of the Forum could be current issues, which promote economic cooperation and increase Finnish interest in Russia. The practical organisation of the Forum could be undertaken by Sitra, the Confederation of Finnish Industries and the Central Chamber of Commerce.

There is a good history of inviting Russian opinion leaders to Finland, and these visits have become an established practice. Partly because of such visits, Finland is fairly widely recognised and respected both by Russian administration and business life. This kind of knowledge of Finland obviously gives a competitive edge to business life and, therefore, networking events with Russian colleagues at different levels should be continued and increased.

Finland has a reputation in Russia of being a safe and clean country as well as a popular tourist destination. Being Finnish is often an asset in business partnerships. Finnish companies and decision-makers must actively uphold Finland's good reputation in Russia by marketing Finland to the Russian

media and by continuously nurturing their contacts with the opinion leaders.

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### Proposals for action

- **A high-level economic Forum (Finland's Russian Economic Forum) is to be organised for representatives of business life and political administration** (Sitra, Confederation of Finnish Industries, Central Chamber of Commerce).
- **Russian corporate managers and politicians are to be invited to learn about Finland** (Ministry for Foreign Affairs, parliament, Sitra).
- **Organising Finland-related training for Russian corporate managers and regional administrative officials is to be continued** (Fintra, other educational organisations).
- **Training on Finland and Finnish practices is to be organised for Russian experts working for Finnish companies.**
- **Knowledge of Finland in Russia is to be promoted** (Ministry of Trade and Industry, Ministry of Transport and Communications, Ministry for Foreign Affairs, Finnish Tourist Board, Confederation of Finnish Industries, Economic Information Office).
- **The Russian media are to be invited to learn about Finland** (Ministry of Trade and Industry, Ministry for Foreign Affairs, Finnish Tourist Board, Economic Information Office).

# Finnish-Russian economic relationships

by Simon-Erik Ollus

## RUSSIAN RAPID GROWTH CONTINUES

The economic growth in Russia has been extensive since the 1998 crisis. The economy has seen an average annual increase of over 6% in the period 2000–2005. This rapid growth has been driven by a correspondingly rapid growth in oil production and by the increasing world oil prices. Moreover, the devaluation of the rouble in 1998 resulted in improved price competitiveness of the country's domestic industry. Furthermore, the prudent economic policy has promoted Russia's economic growth.<sup>1</sup>

The Russian economic structures have strengthened significantly after the 1998 crisis and no similar crisis is foreseen in the near future. On the contrary, the economic growth seems to continue for the coming years. The Russian Ministry of Economy forecasts an annual economic growth of 4.5–6.5 % during the years 2005–2015.<sup>2</sup> A continuous (or even a little slower) growth can be assumed to

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<sup>1</sup> The Russian GDP grew by 6.4 % in 2005.

<sup>2</sup> Similar growth forecasts are given by e.g. the Research Institute of the Finnish Economy (ETLA) that predicts a 4–6 % average growth for 2004–2010. The Bank of Finland short-term forecast from January 2005 forecasts an average 5 % growth for 2006–2008.

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further strengthen the economic structures and increase welfare in Russia.

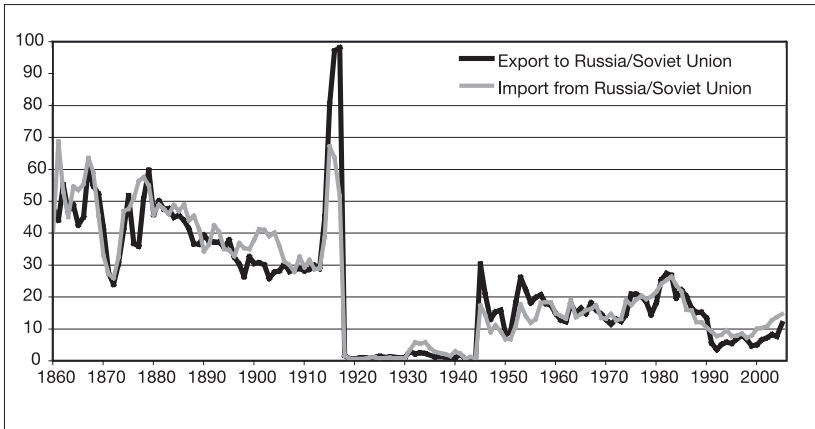
The strong economic performance is also seen in increasing consumption. As real income has increased, households' consumption has annually grown by about 10 % in average during this decade. The increase in purchasing power is reflected also in a fast growing service sector. The middle class is growing and western style consumption habits are becoming more popular. The improved economic situation is also seen in the regions. It is not only Moscow and St. Petersburg, where welfare is improving, but the purchasing power is also increasing in the regional centres. This development is seen e.g. in the large expansion of international retail chains outside the traditional metropolises in Russia.

## RUSSIA – FINLAND'S LARGEST TRADING PARTNER

In 2005 Finland was Russia's 12<sup>th</sup> largest trading partner. In terms of value the trade was significantly larger than Russia's trade with many larger EU-countries. In fact, Finland was the country with the second highest share of total trade with Russia in the European Union. Only Lithuania had proportionally more trade with Russia. Therefore, it is understandable that effective and operational economic relationships with Russia have a major priority for Finland. In 2005 Russia's share of the Finnish foreign trade was about 12 % of the total trade. However, the Finnish dependency on the trade with the eastern neighbour is still much smaller than during the booming years of the bilateral trade in the beginning of the 1980s. Then, over 25 % of the Finnish trade was with the Soviet Union.

The Finnish trade with Russia has grown rapidly since the 1998 crisis in Russia and in autumn 2005 Russia became Finland's largest trading partner. In export, Russia was Finland's largest export market in 2005, but in import, Germany still kept a slightly larger market share than Russia. The value of export was 5.7 billion euro in 2005 and grew by 32 % y-o-y. The value of import was 6.5 bil-

Figure 1. Russia's share of Finnish foreign trade



Source: Bank of Finland, Customs Finland

lion euro and grew by 23 % y-o-y. Although the import from Russia was slightly larger than the export, the trade has proven to be beneficial for both sides. Russia exports raw materials and energy to Finland, which are processed in Finland and exported further. Finland mainly exports machinery, technology and consumption goods to Russia.

In 2005 the largest and fastest growing export category was investment goods. The share of investment goods accounted for 48 % of the export to Russia in 2005. About half of it was mobile phones. Finland exported almost 9 million mobile phones to Russia in 2005. The export of mobile phones grew by 68 % y-o-y in 2005. Export of other high tech goods to Russia increased too. Russia was in fact in 2005 the largest export destination for Finnish high tech goods.

The second largest export category was raw materials and productive goods, which mainly consisted of semi-finished products, machinery parts and equipment for Russian industry. Their share of the export was 25 % in 2005, of which the most significant parts were wood and paper products (8 % of total export) and chemicals (8 %).

The consumer durables' share of export was about 15 %, of which the car export to Russia alone accounted for 7 percentage points. Car export from Finland to Russia grew by 44 % y-o-y in 2005, although no cars produced in Finland were exported to Russia. The export was mainly a side effect of the large car transit freight through Finland to Russia. The transit freight of passenger cars through Finland to Russia was 340 000 cars in 2005 compared to 19 000 cars accounted in Finland's own export. The share of other consumable goods was 11 % and consisted mainly of foodstuffs and pharmaceuticals. Foodstuffs export to Russia has declined slowly in the last years and the share of the export was 3 % in 2005. However, Finland's share of Russia's total foodstuffs import was still large, about 8 %. About 2 % of Finnish export to Russia consisted of energy products, which were mainly oil products, refined from Russian crude oil.

Two thirds of the import in 2005 was energy products. About one third of it was raw materials and productive goods, while the share of investments goods, consumer durables and other consumable goods was mainly marginal. The crude oil import covered in value about 40 % of the import, oil products 14 % and gas 8 %. Nearly

Figure 2. Structure of Finnish export to Russia in 2005

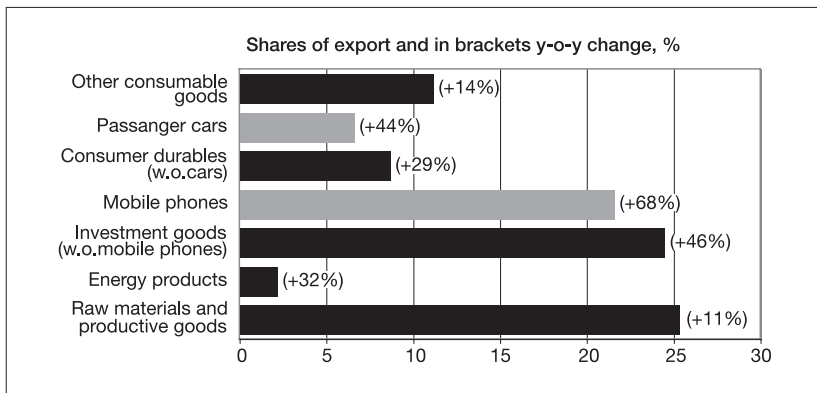
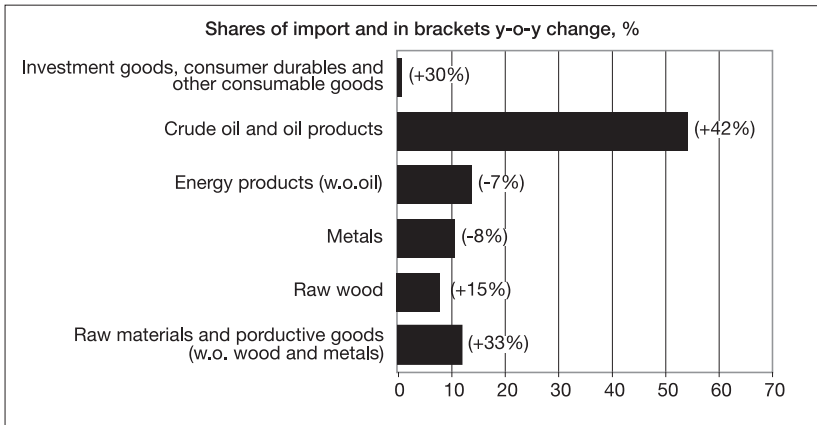


Figure 3. Structure of Finnish import from Russia in 2005



Source: Customs Finland

all of the gas consumed in Finland was imported from Russia. The electricity import has also grown recently and it covered about 3 % of the total value of the import in 2005. In raw materials, iron and steel products' share of the import was 11 % and raw wood's 8 %. Finland is the world's fifth largest raw wood importer after China, India, Japan and South Korea.

### SMALL AND MEDIUM SIZE ENTERPRISES ARE SIGNIFICANT PLAYERS IN RUSSIAN TRADE

Predominant for the trade with Russia is that SMEs are significant players in the export business. According to statistics from the Finnish Customs,<sup>3</sup> the amount of enterprises exporting to Russia was 3700 in 2004, of which a little over 3000 were SMEs, compared to the 1700 enterprises (mainly large ones) dealing with Soviet

<sup>3</sup> Customs Finland (2006), Foreign Trade between Finland and Russia by enterprise size in 2004

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Union in mid 80s during the bilateral trade. However, the market is still dominated by large size companies which have over two thirds of the export in value terms. The annual average of the export to Russia was 290 000 euro for a SME in 2004, while it was 5.0 million euro for a large company. Over half of the SMEs were involved in retail and wholesale business. In real estate, transport and storage business the SMEs' shares were the largest ones, about four fifths of the whole export to Russia.

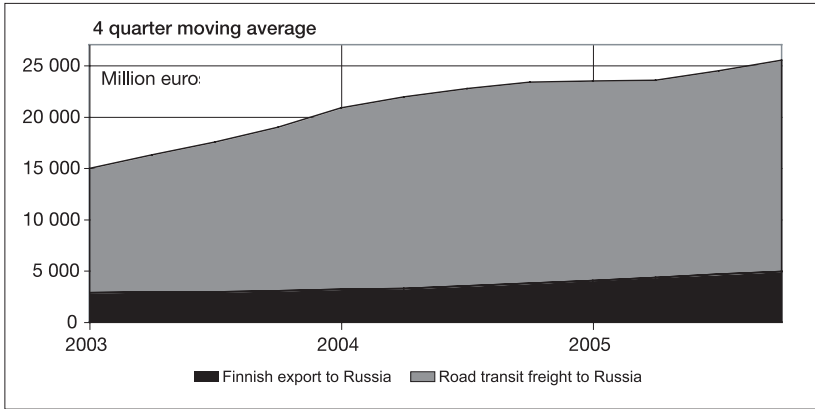
As Russian domestic producers' productivity grows and they start to produce the same products as in Finland but to cheaper prices, the Finnish SMEs will face harder competition on the Russian markets. Due to this changing market situation, Finnish SMEs that want to keep their positions on the Russian markets, have to invest either in production facilities in Russia or in a higher processed production mix in order to keep their competitiveness.

Differently than the export, the import from Russia is still highly concentrated around the large enterprises. Of the 1 200 enterprises involved in import from Russia in 2004, 850 were categorized as SMEs. However, their share of the total value of the import was only about 6 % and a SME's annual import was in average 345 000 euro, while the large enterprises' value of the import was in average 21 million euro. Similar as in the export, half of the SMEs were active in retail and wholesale business. The SMEs dominated the import in real estate, retail and wholesale, car and car services and transport and storage business.

## FINLAND A SIGNIFICANT TRANSIT FREIGHT CORRIDOR TO RUSSIA

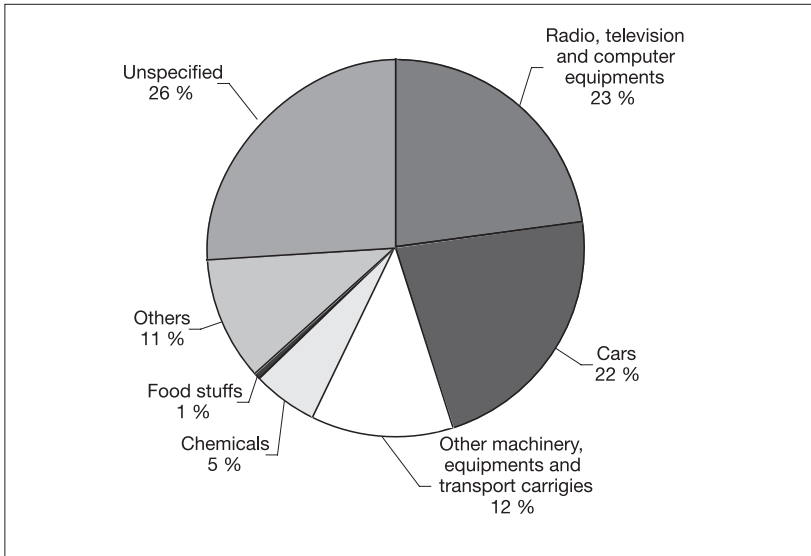
Finland has become a significant transit passage to Russia. The transit freight through Finland to Russia has mainly focused on value goods, while bulk freight goes mainly via the southern transit corridors through the Baltic countries and Poland to Russia. The volume of transit freight was remarkable and about 4 times larger than Finland's own export to Russia in 2005. Hence, the transit to Russia

Figure 4. Value of Finnish export and road transit freight through Finland to Russia 2003–2005



Source: Customs Finland

Figure 5. The structure of road transit freight to Russia in 2005, %



Source: Customs Finland

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and Finland's own export to Russia equal as much as 20 % of Russia's total import. This means that a fifth of Russia's total import goes through the Finnish territory.

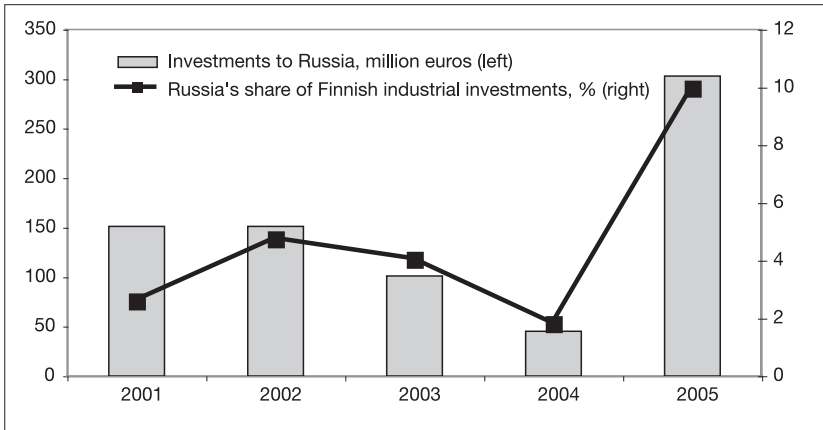
The transit freight in 2005 consisted mainly of cars, electronics, machinery and equipment. The lion share of the transit freight headed to Russia by road freight. In 2005 the value of the road transit freight through Finland was 22 billion euro and it grew by 13 % y-o-y. Some freight also headed to Russia by rail and boat through Finland, but for these transport methods there are no value based statistics available. Finnish harbours also function as important gates for export of Russian raw materials to the world markets.

Although the transit freight's employment and income effect are not so strong as for domestically produced goods, it is still a significant income source for Finnish harbours, storage and transport facilities especially in Southern and Eastern Finland. By distance, Finland is from Central Europe one of the shortest transit corridors to North-Western Russia, but for the Moscow region, the southern corridors are shorter. However, the current competitiveness of the Finnish transit corridor largely relies on safe, effective and good transport and warehouse facilities. On a longer term, however, Russia probably aims for independence of its logistical infrastructure and if Finnish companies aim to keep their strong position in the Russian logistic business, they need to become also significant players on Russia's domestic markets.

## FINNISH INVESTMENTS INTO RUSSIA

There are no reliable investments statistics about Finnish enterprises' investments in Russia. Enterprises are not obliged to report their investments and most of them work in a global business environment, where the origin of investments is open for interpretations. However, some estimates have been presented about the stock of investments to Russia. A recent study by the Research Institute of the Finnish Economy (ETLA), which can be considered quite accurate, estimates the stock of investments from Finland into Russia

Figure 6. Investments by Finnish industrial enterprises to Russia 2001–2005



Source: Confederation of Finnish Industries

to around 1.8 billion euros at the end of 2005.<sup>4</sup> ETLA also takes into account investments made by Finnish enterprise entities in third countries. Their findings are supported by the Confederation of Finnish Industries (EK). In a recent survey for 2005 among its members,<sup>5</sup> EK showed that the Finnish industrial investment flow to Russia grew 6 times from 2004 to 2005 and that a tenth of all foreign investments from Finland made by Finnish industries went to Russia. The survey clearly shows a strengthened belief in the possibilities on the Russian markets among Finnish enterprises.

According to an earlier more detailed survey by EK from 2003, the stock of investments from industrial firms to Russia was around 1.4 billion euros at the end of 2002.<sup>6</sup> Moreover, 80 % of these investments would have been invested into the North West Federal District. The rest is mainly invested in Moscow and its surround-

<sup>4</sup> ETLA (2005), Investoinnit ja investointiedellytykset Venäjällä.

<sup>5</sup> EK (2006), EK:n investointitiedustelu.

<sup>6</sup> EK (2003), Kasvua kehittyviltä markkinoilta?

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ings. The same survey forecasted the Finnish industrial investment stock to Russia to break 2.6 million euros at end of 2007. However, with the growth speed of the current investment flows, this forecast seems to be too pessimistic. Finnish companies increasingly consider investments to Russia.

The recent investment survey by ETLA has also divided the investments according to industrial sectors. Most investments from Finland have gone to the forest, printing, fuel and energy sectors. Finnish enterprises have also invested much in retail sale, foodstuff industry, construction and metal industry. Some of the most significant investments into the Russian markets from Finland are e.g Sanoma-WSOY's ownership of Independent Media<sup>7</sup>, Fortum's investments in North Western Russian power infrastructure, Neste Oil's investments in its Neste petrol station chain in North West Russia, Hartwall's investments into the Baltic Brewery Holding<sup>8</sup>, Telia Sonera's ownership share of MegaFon<sup>9</sup>, Fazer's investments in its bakeries in St.Petersburg, PKC Group's investment in its factory in Kostamus, Elcoteq's investment in its factory in St.Petersburg, Stockmann's investments in its department stores and clothes chains in St.Petersburg and Moscow and Nokian Renkaat's tyre factory in St.Petersburg.

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<sup>7</sup> Sanoma-WSOY bought the Dutch owned Russia media house Independent Media in 2005. However, in ordinary balance of payments statistics the investment is considered as an investment to Holland, not Russia.

<sup>8</sup> Hartwall established jointly with the Swedish brewery Prips, Baltic Beverages Holding (BBH) in 1992. Since then BBH grew to become today Russia's largest brewery. However, BBH is based in Sweden and similar to Independent Media, often considered as investment to Sweden in the ordinary balance of payments statistics. Hartwall was bought by Scottish&Newcastle in 2002, largely because of its ownership in BBH. After the deal the investments to BBH are excluded from the Finnish investment figures.

<sup>9</sup> TeliaSonera is today registered in Sweden. However, the Finnish daughter company operates the business in Russia. Similar arrangements where the Finnish filial operates the Russian business can be observed in many multi-national companies, e.g. SKANSKA and Electrolux.

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The large enterprises' investments into Russia have also brought subcontracting opportunities for smaller Finnish and Russian enterprises. The investments from Finland into Russia have increased the employment in Russia and developed technology transfers, increasing Russia's global competitiveness.

In the investment figures, it is also perceivable that investments in production facilities increase. The products are not aimed only for Russian markets but also for global export. The starting point has usually been small scale assembly. As the procedures have become more stable and experiences have been gathered, enterprises move the whole manufacturing process to Russia. The two pioneers on this field are PKC Group and Elcoteq. Both have their own manufacturing sites in Russia and produce products for global demand from Russia. Their investment decisions are long term and the companies have a strong belief in the knowledge of the Russian employees and the stability of the country.

## RUSSIANS IN FINLAND

Finland has not only gained from investing into Russia, but also Russians have actively invested into Finland. According to statistics by the Bank of Finland, which are based on voluntary reports by enterprises, the stock of foreign investments from Russia to Finland was equal to about 70 % of the stock of Finnish investments into Russia. If assumed that Russian enterprises' activity in reporting their investments to the Bank of Finland is about the same as Finnish enterprises' to report theirs to Russia, the Russian investments into Finland can be considered significant. It is hard to find exact statistics about Russian enterprises in Finland, but according to survey from the Turku School of Economics from 2004, about 2 000 Finnish enterprises were owned by Russians in mid 2004.<sup>10</sup> Of

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<sup>10</sup> Vahtra & Lorentz (2004), Russian Involvement in Finnish Companies – The Energy Sector in Focus, TuKKK.

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these, nearly all were established after the fall of the Soviet Union. It is hard to get a full picture of the ownership in publicly traded companies, but at least 5 of the 500 largest companies in Finland are assumed to be Russian owned. The real figure is probably somewhat higher. Consequently, Russian business activities in Finland are significant.

Finland is also a popular tourism destination for Russians. Finland was in 2004 the most popular destination for Russians inside the EU and most popular after Turkey, China and Egypt. The Finnish border was crossed by Russians 2.1 million times in 2004. Russians were the third largest tourist group visiting Finland after Swedish and German. According to the Finnish Tourist Board, Russian tourists spent 175 million euros in Finland in November 2004–April 2005, and this was the highest total spending of all groups visiting Finland in the period. In 2005 Russians slept 498 000 nights in Finnish boarding houses. For Russians, the most popular areas to visit are central Finland and the capital area. Most visits take place during the winter. Notable is that there is an increasing number of Finnish tourism enterprises that are specialised on only serving Russians. Hence, the Russian tourism's employment and income effect is also significant.

