Monitoring regional differences in Northwest Russia*

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Russian regions neighbour Finland from the northernmost tip of the country all the way to the Baltics. Finland's Action Plan for Cooperation with Neighbouring Areas aims at building sustainable grounds for cross-border economic cooperation, supporting also administrative reforms undertaken in Russia after the collapse of communism. Within this framework, financed by the Finnish Ministry for Foreign Affairs, a joint Finnish-Russian project on economic monitoring of Northwest Russia was undertaken in December 2000. The regions monitored include the Murmansk region, the Karelian Republic, the Leningrad region, St Petersburg, the Kaliningrad and the Novgorod regions. The aim of the project is to provide regular, comprehensive and comparable information on production and demand indicators, foreign relations, and on public sector and social developments in the regions. The bi-annual publication is the first of its kind at this detailed level.

Regular and comparable economic monitoring

The regional reports are produced as a twinning project. Every report is a responsibility of one Finnish and one Russian partner. Thus the reports represent the result of collaboration between the Institutes of Sciences of the Russian Academy of Sciences in the region of Murmansk and the Republic of Karelia and various other scientific institutions in the Leningrad, Novgorod and Kaliningrad region and the City of St. Petersburg with the Center for Markets in Transition at the Helsinki School of Economics who also coordinates the project.

The analysis is based on official statistical information on the Russian Federation and the six regions available. The team is aware of the major shortcomings of the statistical information available. These are, among others, the lack of or deficient information on gross regional product, and employment, and distorted information on foreign trade due to transit trade or practices aimed at avoiding customs duties. An additional problem is created by the diversity of formats among the regions, according to which information is published. Furthermore, not even the official statistical sources are consistent or provide similar information for all the regions. Statistics are also revised relatively often, when better information becomes available. The share of the shadow economy may not be estimated correctly in the statistics. Active enterprises may not be included in business registers and statistics whereas some registered ones have seized to exist in practice.

The list of deficiencies is admittedly long. However, the official statistics are the only source available in a relatively systematic and similar format for all the regions. It can be assumed that the above-mentioned distortions affect them more or less equally. Therefore they can be used as relatively reliable indicators for development trends over time. In addition to the statistical information, surveys and other research-based data have been used in the reports. The ultimate goal is to reach what is behind the figures, to find causes and consequences beyond the statistics. In the relatively small regional economies, single business deals or political and administrative strategies may cause significant fluctuations in statistics not necessarily explained by any underlying economic trends. The cooperative structure of the research team involved is thus well suited to give the reader both the local flavour and the objective comparability needed to truly understand the regional development.

Structural changes in northwest Russian regions

Until the economic reforms began, the Northwest Russian regional economies were run by federal-level planning. A vast structural change occurred in the 1990s, as the collapse of the communist system cut the supplier and customer contacts of the enterprises and markets were opened for competition. In St Petersburg, for example, the previously strong defence-oriented industries of machine building and electronics, lost their production shares to consumer-oriented food and beverages. The textile industry has also collapsed in the city. In the Leningrad region, machine building is still on its feet but has experienced high volatility in production volumes partly due to the rapidly changing number of active enterprises. After 1999, new investments in the industry have positively affected its future outlook. Chemical, wood-working and food industries have replaced machine building as the main industrial sectors in the Novgorod region. (see e.g. Zimine & Bradshaw 1999; Zimine & Bradshaw 2002; Solanko & Tekoniemi 1999; Sutherland et al. 2000).

The drastic structural changes lead the Northwest regions to a deeper crisis than the average in Russia in the mid 1990s. The traditionally strong industries in the district were not competitive and the lack of investment hindered fast-track restructuring of any substantial scale. The recovery, however, has started. Industrial growth rates have mostly followed the all-Russian trends, with rapid positive development especially after the 1998 economic crisis, although slowing down somewhat in 2001. In 2002, the industrial growth in the Northwest federal district was 16.4%, which was considerably more than the average in Russia, 3.7%. The preparations for the city's 300 year celebration in 2003 resulted in an investment boom in St Petersburg. This was best shown in renovations of the historical buildings as well as street construction and maintenance. Over 15% of the 300- year investment came from the federal budget. In Karelia, public funds have also had a major role in investment finance as the growth figures there originate mostly from road contruction projects, and the investment by the October Railways in the quality of rails connecting nortwest regions such as Komi and Arkangel to Finland. In the Leningrad region, investment boom has been experienced also in the industrial sector. In sum, the Northwest Russian economy is still developing to a large extent on the basis of structures inherited from its Soviet past. Nevertheless, the participation of the regions in the global economy and, for instance, the strong domestic demand since the 1998 ruble devaluation increasingly direct the trends in the economic activity.

As in Russia as a whole, the share of services in the gross regional product has increased in the Northwest regions as well. In St Petersburg they account for almost 60% of the Gross Regional Product. New enterprises are established in retail trade, catering, information and other services. Measured by employment growth, services play an increasingly important role- retail trade, catering and transport especially so. Rising purchasing power and changing consumer tastes are expected to pace up this trend even more. Service sector attracts also foreign investment. In Kaliningrad, for instance, close to 40 percent of the foreign investments in 2002 were made in trade and catering. Retail trade growth follows the income development. In Novgorod, retail trade reached the pre-crisis levels of 1998 in the beginning of 2002. Informal economy persists in trade. This shows in a Kaliningrad statistics paradox as consumption exceeds the official figures of population incomes. In the region, the shadow economy consists partly of criminal elements such as tax evasion or even arms and drugs trade, prostitution, and smuggling.

Transport sector revival is concentrated around international and inter-regional trade in raw materials. Karelian transport routes connect the Murmansk natural resources to the production sites in the European parts of Russia, on one hand, and north-western timber to its western European buyers on the other. Leningrad region sees through the traffic into and from St Petersburg and is also the location of important oil terminals. The Russian Federation is not willing to rely as much on the Baltic ports as used to be the case during the Soviet times. The so-called Baltic Pipeline System was invented to increase the country's independence in this respect. Until now it has resulted in, for example, the development of the Primorsk terminal to redirect the shipments to the Gulf of Finland. In St Petersburg, the bad state of infrastructure prevents its use to the full potential. During the decade or so of economic reforms, repair investments have flown more into the historical centre of the city, leaving, for example, the ports underdeveloped. The coordination between different means of transportation leaves also room for improvement (see Dudarev & Suni 2002).

Rising and falling industrial clusters

The backbone of the Northwest Russian industrial production is made of the export-oriented, raw material-intensive energy, metal and wood-processing industries; and the food industry and information technology, growing fast since the 1998 rouble devaluation (Dudarev et al 2002). St Petersburg is the key telecommunications centre in Northwest Russia. The Russian data transmission networks combining the country with Western Europe also go through the city. Other industrial clusters have developed around textiles, shipbuilding, optics, transport and tourism. Of these industries, important in the Soviet times, the optical industry is facing perhaps the most serious difficulties currently. Shipbuilding is concentrated in the Severnaya and Baltiisk yards (Ekspert 2002b). With main industries reaching high levels of growth and population incomes rising rapidly, construction is also booming in the city.

Food and beverages has become the most important industry branch in St Petersburg, Leningrad and Kaliningrad regions. The industry also includes tobacco production, striving in the vicinity of St Petersburg. In the city, the share of food production is approximately 35% of the total industrial production. In Novgorod and Karelia the food industry occupies the second place after fertilizer production (Novgorod) and pulp and paper (Karelia). The devaluation of the rouble in 1998 caused a drastic upturn in the industry as the increasing prices of imported products redirected demand towards domestic production. Russian consumers have also started to favour local brands more.

St Petersburg is a national centre of food production with several success stories such as Baltic Beverages Holding's Baltika brewery and Unilever's tea packaging plant. (see also Dudarev & Suni 2002). The five largest companies in the industry in St Petersburg are all in beer or tobacco business (Ekspert 2002a). The industry serves a considerably wider geographical area than the city itself. St Petersburg is an excellent location for the food production, which relies heavily on imported inputs. In the Leningrad region, Philip Morris Izhora tobacco and Craft Foods Lomonosov coffee packaging are the two major plants in the industry. The fast-growing food industry has also paced up the region's agricultural production, for which the city with its five million or so inhabitants is naturally a lucrative market.

Foreign investment has often targeted food industry in Novgorod and Kaliningrad as well. In the future, the role of the Novgorod region is likely to become stronger in subcontracting for the St Petersburg food, tobacco and beer producers. The Karelian food industry relies on small and medium size enterprises. Interestingly, investment from Moscow has brought viability to meat production in Karelia. Murmansk fishing industry is living through difficult times, despite the inflow of foreign investment it received.

The energy cluster of the Northwest federal district comprises of raw-material production (oil, gas, coal), production of electricity and heat, and energy technology. Socialist Leningrad provided for approximately 70% of Soviet Union energy technology needs (Dudarev & Suni 2002). Energy sector has good growth prospects in the

Northwest, as the district and the nearby regions are rich with raw materials. St Petersburg power industry is expanding along increasing exports.

Metallurgy in Northwest Russia relies on the deposits of ferrous and non-ferrous metals in the district. Before the collapse of the Soviet Union, the main customer for its products was the domestic machine building. From the early 1990‘s, the diminished demand of the defense-related industries at home has been more or less compensated by re-orientation towards the global markets. Metallurgy is the leading industry in the Murmansk region. The low level of diversification leaves the regional economy constantly vulnerable to the world market price developments (see also Rautio 2000). Ferrous metallurgy in Karelia has experienced positive growth due to domestic strategic alliances and resulting improvements in the management of the Kostamuksha Metals Plant, and the Värtsilä Plant.

Russia has the largest unexploited forest reserves in the world, which interests top forest industry players also internationally. Compared to the average Russian, the industry is in good shape in the Northwest, although branch-specific machine building falls behind modern standards. Forests are owned by the Russian Federation and regional authorities issue the harvesting permits in practice. Up to date, the domestic pulp, paper and woodworking industries have not suffered from raw-material shortages. In fact, a share of the annual harvesting quotas are left unutilized, as it is difficult to find qualified workers, and these reserves are to a great extent located in economically unfavorable areas without proper roads to reach them.

Of all parts of Russia, the Northwest has the most experience in forest-related exports. The industry as a whole and pulp and paper especially form the backbone of the Karelian economy (see e.g. Autio 2002). Outworn machinery and the underdeveloped road network hinder the development of the sector, as does the fear of losing jobs in the number one industry by employment in the region (see e.g. Kotilainen 2001). In the long run the competitiveness of the Karelian forest industry in the international market is bound to weaken, were it not modernized rapidly. Most of the exports are still in the form of timber, saw timber and other low-value added products. As two major plants were modernizing in 2002, and the Segezha operations, which were recently transferred from Swedish back to Russian hands, gained hold of a regional harvesting organization, prospects seem good for the situation to gradually change for the better. In the Soviet Union, raw-materials were brought to Karelia from as far as Siberia. The role of the forest industry is on the rise also in the Leningrad region where five new plants were being built in the beginning of 2003.

The Northwest economic growth leans thus on the growth of the service sector, together with the industries described above. The development of these clusters then feeds in its turn the growth of adjacent sectors, which again has a cumulative effect on consumption, living standards and new production (see Dudarev et al 2002). Clusters become local knowledge centers, in which producers and customers develop strong ties. For example, Lenenergo and the Northwest Shipping Company work closely with each other (Dudarev & Suni 2002). Central to the clusters are the unofficial relations, built on trust. This tradition is also partially inherited from the times of socialism (see Dudarev & Suni 2002; Kosonen 2001; 2002). Some of the clusters are tightly controlled by the so-called oligarks - owners of varying financial-industrial groups. In St Petersburg, for instance, they are engaged in the power and food industries, in banking, and in machine building (Filippov 17.4.2004).

Development in 2002 and beyond: Regional disparities widening

In general, Northwest Russian regional economies seem to be getting gradually on their feet after the collapse of the Soviet system. However, the GDP per capita in, for instance, St Petersburg, is still just a tenth of that in Finland (Dudarev & Suni 2002). In addition, the development is not equal across the regions as the resource-rich northern regions, Murmansk and Karelia, first saw a deeper recession, and, after that, still constantly fall behind their southern neighbors by several economic and social indicators (see also Juurikkala 2002, Sutherland et al 2000; Tykkyläinen & Jussila 1998; Zimine & Bradshaw 2002).

In 2002, industrial production grew faster in the Leningrad region (35.6%) and St Petersburg (31.4%) than anywhere else in Russia. The Novgorod and Kaliningrad regions also fared well with growth figures around 7- 8%. These positive results took the Northwest federal district growth levels as a whole well above the Russian average: 16.4% compared to 3.7%.3

The Novgorod economy is in a relatively good shape, leaning on the development of the fertilizer, food and woodworking industries, and also agriculture. The federal government decided to cut transfers to the region despite local resistance. Kaliningrad growth has accelerated after a law on the Special Economic Zone was put in force in 1996. Growth figures have, however, fluctuated considerably during the years of economic revival. Light industry and machine building were the fastest growing branches in 2002, as, for example, TV sets, vacuum cleaners and cars are assembled in the region for the domestic markets.

In contrast with the other four monitored regions, the northernmost two fell clearly behind both the average growth rates in the federal district and in the whole Russia in 2002. In Karelia, positive growth was sustained but at a meager level of 2.2%. In the Murmansk region, industrial production decreased by 3.5%. These two regions are heavily dependent on the world market developments for their main products- pulp, paper and timber for Karelia, metals for Murmansk. Especially Murmansk economic indicators have given little reason to celebrate for years in a row. Due to the low level of diversification, the vulnerability of the metal industry to the world market prices is directly reflected in other spheres of the economy, such as transports, and the development of the region in general. In Karelia, the main challenge is the urgent modernization of the forest industry. A major obstacle in the process is the public fear of losing jobs.

After three years of positive investment development and subsequent industrial growth, investment decreased by 6.6% in the Northwest federal district in 2002, whereas in Russia as a whole investment growth was positive, at 2.6%. Industrial investment was down while the preparations of the city of St Petersburg for its 300-year festivities continued strongly, as did large-scale transport infrastructure projects in Karelia. The investment growth in Kaliningrad was also due to public funding. The other three regions witnessed declines.

In all of the Northwest regions, internal funds of enterprises are a major source of investment financing. In St Petersburg, internal funds accounted for less than 40% of the total investment in 2002, whereas they accounted for around 55% in Karelia, and for over 60% in the other four regions. Thus one reason for the drop in investment was evidently the decline in the profitability of enterprises, resulting from higher producer than consumer price inflation, and from trends in the world market prices for the products of the export-oriented industries. Certain investment-related federal tax incentives were also abolished. After the rouble devaluation following the 1998 financial crises, some level of saturation for domestic consumer-market oriented industrial investment has perhaps also been expected.

Nevertheless, there have been increasing concerns throughout the Northwest federal district regarding the diminished attractiveness of investment. St Petersburg has concerns over losing investment to the surrounding Leningrad region, due to the better plots and infrastructure available for greenfield investment. Interestingly, at the same time in the province, Novgorod is seen as winning investment, and especially foreign investment, in terms of competition between the two. Both have special programs to attract foreign investors. The Kaliningrad Special Economic Zone has been relatively successful in this respect, too.

In line with the general investment decline, the total foreign investment activity in the Northwest federal district declined considerably in 2002. St Petersburg lost its previous number two position in Russia, and is now positioned fourth after Moscow, the Omsk and the Sverdlovsk regions in attracting foreign investment. The majority of foreign capital invested in the city was once again in the form of commodity and other credits to the industry, especially food. The major countries of origin of the foreign investment were the Netherlands, the United States, Luxemburg and Switzerland. In the Leningrad region, the exhaustion of the foreign investment stream, a decline of over 50% from 2001, was even more serious than that in the total investment (close to 40%). In relative terms, however, the region is still in the top class in the Northwest federal district regarding investment attractiveness, as 35% of the total foreign direct investments (FDI) in the district went to the region, and 25% to the city of St Petersburg.

The other four regions (Murmansk, Karelia, Novgorod and Kaliningrad) have attracted only a small volume of investment compared to the St Petersburg area. The pattern has remained the same for several years.

The food industry also dominated foreign investment inflows in Novgorod, with forest industry in second place. Majority of investment was in other forms than direct investment in equity. Danish, German and Finnish companies have been active in the region. It is also worthwhile to note that the largest industrial enterprise in Novgorod, AKROn, accounting for approximately one fourth of the total industrial production in the region, bought production facilities in China in 2002. AKROn transferring parts of its current Novgorod operations abroad would pose a major threat to the regional economy.

In Kaliningrad, foreign investment almost doubled in 2002, though was still fairly low due to the modest level of 2001 to start with. Traditionally, trade and catering have received the lion's share of Kaliningrad's foreign investment (see also Kivikari et al 1998). In 2002, 50% suddenly went to the oil and gas sector. Over half of the investments came from Cyprus, in the form of loans, and in the last quarter of the year. All these facts point at a single deal, most likely a loan to one of Lukoil's subsidiaries. The toll-free Special Economic Zone has attracted especially German, Polish and Lithuanian companies to start production of food and furniture, and TV set as well as car assembling.

In 2002, foreign investment in Karelia was back to its 2000 levels, approximately half of the figure for 2001. This development was explained by the leasing of an expensive fishing ship from Cyprus in 2001. In Murmansk, the opposite was true, as foreign investment almost doubled in 2002. The growth was accounted for by various kinds of loans. About 60% of the funds came into the fishing industry, and Norway was the number one country of origin.

The foreign investment in Karelia comes mostly from Cyprus, the United States, Germany, Finland, Estonia and Belize. Main targets are food, pulp and paper, and wood-processing. Special investment incentives in Leningrad, Novgorod and Kaliningrad regions have no counterpart in Karelia. Quite the contrary, the investment climate has been relatively bad (see also Hirvensalo & Lausala 2001, Eskelinen et al 1997). Foreign investors have suffered from the regional bureaucracy, there have been attempts to control the boards of foreign companies, and, for example, the use of foreign employees has been a potential target for restrictions.

All in all, the foreign investment trends in the district are subject to large single projects and thus to constant fluctuations. For the sake of comparison, when the

Northwest federal district of Russia received a total of approximately USD 333 million worth of FDI in 2002, the Baltic States (Estonia, Latvia and Lithuania) received net FDI inflows of USD 185, 389 and 715 million respectively, during the same period.4 Geographical proximity seems not to have been a major decision factor in the Northwest Russian foreign investment. Moreover, a major part of the investments to the district is made from well-known offshore locations, indicating repatriation of what were originally Russian funds to the economy. Offshore investment is rising in Russia in general, partly due to the worldwide economic slowdown, which has reduced the investment profitability of other countries.

The social development in the six regions is polarized as St Petersburg and its surroundings fare better than the others also in this respect. Disposable incomes have risen and strong domestic demand has been a major driver in the Russian economy in general in the recent past. Inflation has moderated, and retail trade has experienced growth around 10% for several years. Murmansk and Kaliningrad have not been able to keep pace with the Russian average. Regional wage differences are a result of varying public sector and minimum wages, as well as pensions, among other things. The region-specific industrial structures also affect the income development, as for example St Petersburg has become a centre of such high-paying activities as banking and finance. Also, some industries such as food, again concentrated around St Petersburg, have developed more positively than others – such as metallurgy in Murmansk – thus enabling pay rises. A special feature of the Kaliningrad economy is that the household expenditures typically exceed the official figures for household income, which reflects the relative size of the unofficial economy in the region. It may thus be misleading to draw the conclusion from the statistics that the Murmansk and Kaliningrad consumers would experience similar difficulties, although retail trade growth rates seem even lower in Kaliningrad than in Murmansk.

In St Petersburg, the share of other products than food is over 50% of the household expenditures, whereas in, for instance, Murmansk, the situation is vice versa. Despite the relative success of St Petersburg in raising the general living standards of its inhabitants, it is still important to remember that the development is polarized not only between but also within regions and cities.

In all six monitored regions, natural population growth has remained negative. The situation has been especially difficult in the Murmansk region, which also faces high and continuous net emigration. Half of the workforce in the Northwest federal district is in the city of St Petersburg (Dudarev & Suni 2002). At around 4% in 2002, the unemployment in the city has decreased constantly since 1998, and was less than in the surrounding regions, and only half of the average in Russia. Commuter traffic from the Leningrad region is considerable and involves all fields of the economy. Although more people move in than out from St Petersburg, the city still suffers from brain drain as Moscow has attracted the well-educated, highly qualified part of the workforce already since the mid 1990‘s (Dudarev & Suni 2002). The rapid development of the ICT sector and also the city’s position as number 40 in the world by academic publications balance the picture somewhat. An emphasis on education has traditionally been the strength of the city’s labour market. In the 1990‘s, however, it did not prove sufficiently flexible a resource for the city to keep pace with, for example, Moscow’s development levels.

In the Leningrad region, unemployment has been relatively stable, indicating that the industry manages to expand production with the current number of employees. In addition, layoffs are still rare particularly in the enterprises with government ownership. The extent of the shadow economy and the abundance of cultivated private plots in the region help the people somewhat in their everyday needs. The structure of the employment is a source of concern as the unemployment level among the people with secondary or higher education is higher than among the people without formal education.

The northern regions of Karelia and Murmansk are in a less favourable position than the other regions also by unemployment. The divide is also visible in the regional budgets. In St Petersburg and the Leningrad region, revenues exceeded expenditures in 2002, whereas the other four regions ran deficits. The 2001 tax reform redirected revenues to the federal government coffers. Also the diminished corporate profits and the lower profit tax rate have been to blame for the declining regional budget revenues.

In conclusion, the differences in the Northwest regions’ development are clear and continue growing. The problem-ridden region of Murmansk has put high hopes on president Putin’s recently established federal districts in supporting the peripheries. Up to date, these hopes seem overly optimistic as concrete measures are yet to be seen.

Inter-regional relations in Northwest Russia

In the Soviet Union, regions were an integral part of the division of labour set in Moscow. For example the light industry in the Leningrad region mostly received its production targets and inputs from the Leningrad city. The collapse of the system broke the established economic ties and forced the regions to reorganize their role both inter-regionally and internationally. The situation came close to a catastrophe and for example in the Novgorod region, industrial output sunk by 46% before the new rules of the game had been adopted. In the region, mainly chemical and wood-working industries remained viable from the industrial structure of the past Soviet times.

As a result of the forced reorganization of relations, all regions became more open towards other Russian regions and the international markets as well, and especially so for the regions most dependent on exports. In 1989, 10% of the industrial production in the Republic of Karelia went to exports. Ten years after, the same figure was as high as

65%. In the Murmansk region, the importance of foreign trade has also become ever clearer. For example reindeer meat is almost completely exported, mainly to Sweden, and does not reach the local consumers. (Didyk 17 April 2003). The fishing industry also targets Norway more than the domestic market. The problems in the raw material exports are mostly due to the world market price fluctuations, especially for nickel.

The main export destinations of Murmansk are Norway for fish, and the Netherlands for non-ferrous metals and apatit concentrate. Finland is the major source of imports, but its share of the total foreign trade of the region has diminished recently. Finland is the most important trading partner of the Republic of Karelia, accounting for 33% of the region's exports, consisting mostly of timber, pulp and paper, and 43% of imports, mostly machinery.

Finland is an important target country for Novgorod as well, followed by Germany and China. The export business of the region to China concentrates in fertilizers and machinery and equipment for nuclear power production. The Special Economic Zone in the Kaliningrad regions has paced up both exports (oil, fertilizers, timber, pulp, ships, boats, vodka) and imports (food, car parts, wooden products, petrol, amber, and different consumer goods).The by far most open region of the Northwest district is the city of St Petersburg. The products of the city are also more advanced technologically – for example ships – than those of the raw-material exporting neighbours. Food and machinery are the main import categories. The most important trading partners are Germany, Finland, the United States and the Netherlands. The business traditions already from the Soviet times with China and India have also continued to date.

The inter-regional economic relations of the Northwest regions with each other are perhaps surprisingly not very well developed. This is caused partly by the difficult general situation the enterprises found themselves in, in the times of serious restructuring, the heavy bureaucracy hindering relation building, and the low standards of the transport infrastructure in the district. In addition, the regions compete to some extent for the same export markets. The existing internal links are then found both in trade and ownership. The main market for Kaliningrad vodka, paper, food products, furniture and cars is Moscow, from where oil, electricity and metals are bought in exchange. Novgorod is intensively involved in St Petersburg tobacco and beer industry sub-contracting. Karelian pulp and paper industry acquires cheap timber from Arkhangel and Vologda. Karelian stone is sold to Moscow and St Petersburg, which, in their turn, sell imported consumer goods to the region. Imports have indeed grown fast in the Leningrad region.The privatization of production in the 1990's transferred ownership both within the Northwest and to other regions of Russia. The Kostamuksha plant in Karelia, for example, is owned by Severstal of Vologda, part of Karelian wood-processing is controlled by investors from Arkhangelsk, fish industry in Petrozavodsk by investors from Murmansk, shipyard and radio - from St Petersburg, and so on. Moscow owners are involved in aluminium production, construction industry, meat processing, railways, banking; Bashkortostan banking, and Tshelyabinsk metal processing (Värtsilä plant). Also the Segezha paper mill left behind by Swedish investors is nowadays in Russian hands. It remains to be seen what the effect of the establishment of the Northwest federal district by president Putin will have on the internal relations in this geographic area. Up to date, initiatives have been made to combine Novgorod and Pskov with each other, and in a similar manner to integrate St Petersburg and the Leningrad region, as also Arkhangelsk and Nenets autonomous area.

Challenges of further research on the Northwest

The Russian economy is growing. In 2002, GDP growth in Russia was around 4%. In the last couple of years, the growth rates in especially industry have been considerably higher in the Northwest federal district than in Russia on average. According to a recent business barometer in the district by the Finnish Central Chamber of Commerce, managers have positive expectations regarding both their own activities and the general economic development. The current growth rates and optimism do not, however, suffice to guarantee either future positive development of the Northwest regions in general, or catching Moscow levels of prosperity, in particular. The apparent needs for structural changes and investment create opportunities for Finnish partners as well. The potential is further strengthened by the complementary nature of the Finnish and Northwest Russian industrial clusters. The backbone of the economy is built around the same industries, but the concentration differs as the Finnish companies mainly produce final goods for the international markets. As is clear from the above description of the economic structures and development in six regions of Northwest Russia, it is necessary to review the regions and their importance to the Finnish economy in a global context. Trade with Finland has been important to these regions, but in especially investment, other players have been more active in the field. The focus of Russia's foreign trade is currently shifting more and more to the Baltic Sea and the Northwest. New terminals are being built and planned both in the vicinity of St Petersburg and Murmansk. The importance of these areas neighbouring Finland is growing for the entire European Union.

In developing further the cross-border cooperation and utilizing the economic potential in Northwest Russia, systematic and comparable economic monitoring of the rather heterogeneous regions has found its place as a reliable source for actors at all levels. The true long-term benefits of monitoring may, however, be evaluated only after some time, as following the trends is essentially a continuous task. It is also apparent that in order to develop deep knowledge of the phenomena underlying and driving the development trends in Northwest Russia, or in the Russian regions in general, rigorous research and analysis of, for example, the enterprise sector, is needed beyond the concept of monitoring. In filling this gap, both qualitative and empirical research at the micro level may prove useful tools.

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[1] Northwest federal district comprises of 11 Russian regions: the Republic of Karelia, the Republic of Komi, Arkhangelsk, Vologda, Kaliningrad, Leningrad, Murmansk, Novgorod and Pskov regions, the city of St Petersburg and the Nenets autonomous area.

[2] Source: Bank of Finland / Bank of Estonia, Bank of Latvia and Bank of Lithuania.