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## Trading with Russia: Soft power and country risk

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### Geographic proximity

Stalin's famous remark in the fall of 1939 to Finland's chief negotiator (and later president) J.K. Paasikivi was ominous and foreboding: "**There is nothing we or you can do about geography.**" It is therefore no minor achievement for Finland to have survived the War, and go on to turn the situation around during the post-war years to make geographic proximity with Russia a competitive advantage.

It fits the Finnish historical narrative to say the crushing war reparations imposed on it forced our industrialization. Indeed, the last train carrying reparation goods crossed the border in 1952 – the year of the Oslo Winter Olympics and Helsinki Summer Olympics. The next day's train with similar cargo signaled the beginning of a new export relationship. Likewise, when the first oil shock hit in 1973, Finland overnight doubled its exports to the Soviet Union, rebalanced trade, and eventually created the affluent Finland we know today.

With these initial tidbits, I want to illustrate the long history of Finno-Russian trade relations. The first regular passenger train connection to Moscow from the West was the night train from Helsinki in 1954. The first regular Western commercial aircraft to land in Moscow was a Finnair flight in 1956. The first tourist bus to enter the Soviet Union carried Finnish tourists to Leningrad in 1958. The first modern high-speed train crossing the Russian border without stopping for tedious border and customs procedures was the "Allegro" between Helsinki and St. Petersburg. The Allegro was inaugurated by President Halonen and Prime Minister Putin in December 2010. Travel time was initially cut from five hours to three-and-a-half hours, and in coming years the time

should be further reduced to about three hours. Geography, it appears, is not always a curse.

## Soft power

There is an element of Finnish soft power today in Russia's otherwise cut-throat market. Indeed, some of the most famous brands in the mind of the Russian consumer are Finnish. To name just a few, we have "Valio" and "Viola" for dairy products and "Tikkurila" for paints. Prime Minister Putin was somewhat taken aback in March 2010 when he met Finnish business leaders and learned that Nokian Tyres was the largest exporter of consumer goods "Made in Russia." The Nokian Tyres plant in Vsevolozhsk outside St. Petersburg is larger than its sister production facilities in the town of Nokia, Finland.

While "soft power" is a much-used, somewhat fuzzy, concept, I would like to offer a couple examples to clarify my take on the term.

## St. Pete

The first, and more concrete, example is the persistent work to revive the natural systems of the Baltic Sea and fight eutrophication of its waters – and, more importantly for our discussion – the impacts on St. Petersburg, a city with a population larger than Berlin's. Still in 1978, the city dumped all its raw sewage into the Neva and the Gulf of Finland. Today less than 5% of St. Petersburg's waste water remains untreated. In coming years, the amount of unfiltered waste-water reaching the Neva will fall close to zero. This is testimony, of course, to the commitment and funds of Russia's neighbors, especially Finland, to fixing a huge problem. Yet without the personal engagement of Mr. Felix Karmazinov, the enlightened chief of "Vodokanal," money for the St. Petersburg waterworks alone would have never turned the St. Petersburg wastewater situation around. At the St. Petersburg Economic Forum this June, Mr. Karmazinov noted with appreciation that the seed money for human resources training from the John Nurminen Foundation almost twenty years ago is what got the ball rolling. Vodokanal today is the flagship of Russian waterworks projects and trains specialists from all over Russia. Vodokanal is the first water utility in Russia to implement chemical phosphorus removal in its wastewater treatment plants. President Tarja Halonen was present at the inauguration of the last phase this July. The "Northern Capital," as the city is again called, has become a stakeholder in promoting environmental awareness in Russia and demonstrating the long-term financial logic of investing in clean technologies.

The Finnish efforts in the Gulf of Finland are reminiscent in many ways of Norway's commitment to clean up the radiological dumps on the Murmansk coast. What we see here is that, at the end of the day, it is not merely a question of funding, but promoting a mind-set that recognizes

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responsibilities to one's own population and the environment. The reshaping of Russian thinking on these matters shows that the benevolent exercise of soft power can really work.

The example of Norwegian soft power that served as a role model for Russia is the idea of channeling oil and gas revenue into a sovereign wealth fund. These funds saved Russia in 2008. And the creation of the funds is the claim of fame of Alexei Kudrin, Russia's minister of finance.

The fact that St. Petersburg is no longer a decaying provincial tourist destination with rusting smoke-stack industries, and instead is being restored to its glory as Russia's Northern Capital is a major achievement. In all fairness, it should be acknowledged that it has coincided with Vladimir Putin's time in office. In any case, the renaissance of St. Petersburg has broad implications regionally and internationally.

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## Visas

My second example is Finland's work to reform visa processing. While the complete waiving of the visa requirement for citizens of the Schengen countries and Russia (and Ukraine for that matter) is still some years off, Finland's efforts to liberalize visa practices in line with the Schengen Treaty has produced stunning results. Former Finnish Prime Minister Mari Kiviniemi observed last December in St. Petersburg that Finland expected to issue a million visas in 2010 to Russian citizens. What this means in practical terms is that cross-border travel for average citizens of Russia is now fully normalized. And the numbers are expected to keep growing. The Consulate General in St. Petersburg alone expects to issue a million visas this year. This boom in cross-border travel translates to an increase of approximately 30% a year. The over five million land-border crossings last year had a significant and positive impact on the economy of southeastern Finland. The Russian presence in the streets and shops of Helsinki has not been as great since before 1918.

The changes in visa policy also evidence the use of soft power. Russians visiting Finland have the personal experience of vacationing, shopping or doing business. Enhanced by the stark contrast crossing the border it contributes to the already positive image of Finland as a major partner of Russia.

Another Norwegian parallel comes to mind here. We see a growing exchange with Murmansk and Archangel, especially between East Finnmark and the Pechenga and Murmansk areas. Unlike Finland, Norway has signed a Local Border Traffic Agreement with Murmansk under the Schengen Treaty that will allow easy traffic flows within a 30-kilometer zone.

## Investments

**Fazer**, a well-known Finnish company and brand has made major inroads into the baked goods market in St. Petersburg and is now growing its presence in the Moscow region. **Itella**, the former Finnish Post, is the largest operator of high-end logistics warehouses in Russia. It employs about 5,000 people in Russia, and its network spans the country, overseeing material flows as far away as Vladivostok. The Finnish construction firm **YIT** is the largest non-Russian housing builder in the country. **Oriola KD** is Russia's 6<sup>th</sup> largest wholesaler and retailer of pharmaceuticals in Russia, and number-three in Moscow. Again these are just a few examples to illustrate the diversity of Finnish investment in Russia.

While most Finnish investments, however, are in the field of trade and services, the largest Finnish investment is **Fortum's** four-billion-euro investment in Russian energy generation in Western Siberia and the Urals. It is the largest investment ever by a Finnish corporation outside Finland. The cumulative sum of Finnish investments will exceed eight billion euros, with some of the money coming from subsidiaries in Europe.

## Predictability

At the St. Petersburg Economic Forum last month, Tapio Kuula, CEO of Fortum, stressed the importance of **predictability** when deciding to invest in Russia. Being inside the tent, that is, already being an investor in Russia with good standing, puts corporations like Fortum in a position to influence both political decisions and the drafting of legislation. It also puts pressure on the Russian Government to be consistent in application of the announced rules of the game. Be it the energy market or other fields, **consistency and predictability** are determinative of the overall investment climate in Russia.

As any big investor knows, a direct dialogue with the Russian political leadership is essential. The captains of Finnish industry in recent years have met twice with Prime Minister Putin. A third meeting was scheduled for June, but because negotiations to form a new Finnish coalition government dragged on, Mr. Putin's visit to Finland was postponed.

The logic of these meetings is to secure support for major investments and advance conceptual issues. These meetings are not used as forums to air laundry about red tape or excessive bureaucracy, but rather present concrete proposals that will improve investment conditions through legislative changes and benchmarking to best practices.

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In noting other key players and bodies significant for trade, I would list four:

- The Bilateral Trade Commission chaired by Foreign Trade Minister Alex Stubb and Vice Premier Sergei Ivanov;
- The Business Council established by the prime ministers in 2010, which is chaired by Jorma Ollila of Nokia and Vladimir Yakunin of Russian Railways;
- The Northern Dimension Business Council chaired by Tapio Kuula of Fortum and Alexei Mordashov of Severstal; and
- Ambassadors Matti Anttonen and Alexander Rumyantsev

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## Stability and reform

The ultimate, and perhaps only, way to influence Russian legislation is from the inside. Major investors must have access. Without it, nothing moves in Russia. This is a very pragmatic way of managing traditional country risk. However, there is a political aspect to country risk, what might be called “**Russia risk.**” In its core, it is a form of political risk beyond the scope or control of investors. Even if it could be influenced from the outside, any impact would likely be marginal. All I can say is that the integration of Russia and its economy into global structures remains the best bet for Russian society in its efforts to catch up with the developed world and embrace modernity. The race between stability and reform cannot be a dead heat lest it end in *zastoi* – stagnation.