

Developments in the Russian Western Gateway of Finland

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Summary

From 2000 on Russian economic development took off, and Finland came to play a major role as a route for Japanese exports to Russia. Up until several years ago, practically the entire volume of household electrical goods and new cars exported to Russia from Japan and the ROK crossed the land border via Finland. One also hears, however, that the recent move away from Finland by companies involved in export household electrical goods is proceeding. Additionally, from autumn 2008 on, the sudden change of the global financial crisis hit, and the route also suffered the effect of a sharp decrease in transit freight. In this paper I have brought together the developments for Finland as the transit export route to Russia from the west.

1. Finland's Role in Japan-Russia Trade

1) The Growth of Japan-Russia Trade and Transportation Routes

From 2003 on Japan-Russia trade also expanded rapidly, against a backdrop of the growth in the Russian economy. In the six years from 2002 to 2008, with the total amount of imports and exports expanding 7-fold, Japan's exports expanded 17-fold and Japan's imports 4-fold.

The thing which drove the Japan-Russia trade which achieved high rates of growth was Japan's export of automobiles. By the commodity structure of trade in 2008, 77.4% of Japan's exports to Russia were automobiles and their components, followed by: general machinery (11.0%), manufactured goods classified by materials (4.7%), and electrical equipment (3.7%). Approximately half of the manufactured goods classified by materials were tires.

Looking at the number of exported automobiles, constituting the overwhelming proportion of exports, Japan exported 1,044,842 vehicles to Russia in 2008. Of those 975,760 were passenger cars. In terms of passenger cars, there were many secondhand cars; the ratio of new cars to old was 46:54, and in monetary terms, 72:28. In the six years from 2002 to 2008 the number of exported automobiles grew sharply, 17.5-fold, and for new passenger cars taken alone, 30.5-fold.

Meanwhile, Japan's imported commodities were centered on resources: crude oil and petroleum products (46.7%); coal (11.8%); metals (24.5%); timber (4.2%); and foodstuffs (9.6%), including seafood.

Looking at the distribution route of these trade cargoes, the exported secondhand cars and the greater part of imports entered or left the eastern gateways of Russia via the Sea of Japan. In contrast, among the export commodities, the greater part of such things as new vehicles and electrical equipment were brought into Russia via the western gateways of Russia, particularly via Finland. Converting into monetary terms, approximately 60% of Japan's exports to Russia in 2008 were via Finland.

Moreover, besides these, there are also many instances of Japanese brand-name electrical equipment, produced in other countries, heading to Russia via Finland, and for Japan shows how much Finland transit has gained its trust.

2) The Impact of the Global Financial Crisis and Russian Protectionism

The course of events since the Lehman Shock of September 2008, however, has shifted rapidly. The global financial crisis that began with the failure of US financial institutions has paralyzed Russia's financial functions, and the Russian economy in its entirety has fallen into a deep recession. Russia's trade has also contracted, and Japan-Russia trade, which had been on a continual, upward trend, has also plunged.

The paralysis of financial functions in Russia directly hit the sales of automobiles. Japan's exports of automobiles, which had been surging like a flood until early autumn 2008, suffered a devastating blow. The number of passenger cars exported to Russia for January to September 2009 plunged dramatically compared to the same period in the previous year—new cars down 89.5%, and secondhand cars down 92.6%—and even in autumn 2009 there is no sign of any recovery.

A cause of the slump in exports of automobiles, in addition to the financial crisis, is also the influence of the protective tariff measures that the Russian government put into operation. On the pretext of the protection of Russian domestic manufacturers, they raised, from January 2009, the import duty on new passenger cars from 25% to 30%, and from 10% to 25% for lorries as well. Moreover, regarding secondhand cars, they raised the duty 2-to-3-fold, essentially prohibiting imports. The raising of duties, which had initially been a nine-month temporary measure, has been extended further, and for secondhand cars it is expected that it will be made permanent.

3) The Background to Finland Transit

Why did Japanese freight, for which the final destination is Russia, come to be transported via Finland?

As direct maritime transportation routes from Japan to Russia there are: 1) the routes which land freight at the Far Eastern ports, Russia's eastern gateways; 2) the routes which transport freight to Europe's major ports via the Suez Canal, and land it at Russia's northeastern ports, such as Saint Petersburg, by feeder-boat; and 3) the routes entering the Black Sea ports of southern Russia. Aside from this, there are the transit routes which cross Russia overland, utilizing the ports of third countries—routes via Finland, the Baltic states, other European ports, and China are utilized.

In the case of trade containers entering Russia from all over the world, a selection is made from the various

routes depending on the point of embarkation and the point of destination. Breaking down the maritime containers that Russia imported in 2007 by region of discharge, they are: the Baltic ports (76%); the Far Eastern ports (14%); and the Black Sea ports (10%). The Baltic ports can be further divided between Russian ports (47%) and non-Russian ports (29%). For the Russian ports, Saint Petersburg Port is the largest (41%), and the non-Russian ports come in the order: Finnish ports (19%); Latvian ports (5%); Estonian ports (3%); and Lithuanian ports (2%).

For Russian ports, with the congestion and delay from the deficiencies in handling capacity being serious, it is necessary for transit transportation via neighboring countries to make up the deficiency. Moreover, the employment and economic benefits are attractive for the transit ports.

It was around 1996 when the Finland transit of export products from Japan, which have Russia as their destination, got into full swing. Finland's easy-to-use bonded warehouses and relatively easy overland customs clearance are the acclaimed result. The transit freight was household electrical goods, office machinery, automobiles, and motorcycles, etc. In addition to Japan, ROK manufacturers also followed suit.

The transit transportation mechanism in a nutshell: store the freight in Finnish bonded warehouses close to the Russian border, and after payment from the Russian side has been confirmed, Russian lorries pick the freight up, cross the border by road and go across to Russia. The customs formalities are ordinarily carried out in Moscow by a customs clearance agency. With this method foreign firms have been able to export to Russia without entering into Russia's troublesome customs formalities and complex conditions of passage. This system is called offshore customs clearance.

The problem for Finland transit is that unlawful acts of tax evasion had taken place among the customs clearance agencies on the Russian side. Piecing together the talk of those involved, invoices had been altered immediately prior to Russian customs clearance, and reducing the customs duties had been carried out on a routine basis.

The Russian government launched a curbing of dishonest practices; in 2000 it introduced the Green Corridor system for the customs clearance of finished cars, and was successful in increasing transparency. While they have tried to introduce a similar system for household electrical goods too, it is said that it still hasn't assured transparency. The Russian government takes it that there is leeway for dishonesty, such as the altering of invoices, to get into the transit transportation system itself, and is promoting direct importation from Russian ports. There is also a move to increase transparency by introducing electronic customs clearance systems.

Maritime transportation routes are used in the main for the transportation from the place of production to Finland. In the case of goods originating from Japan, they are transported via the Suez Canal to core European ports, such as Hamburg and Rotterdam, are transshipped onto feeder boats and transported to Finnish ports.

After such a history of development, today also automobiles (new vehicles) and electrical equipment are

the main Finland transit commodities from Japan and the ROK. Recently, however, the moving away from Finland of Japanese and ROK firms is continuing to occur for four reasons.

First, the movement of firms to attempt to precisely correspond to demand by constructing warehouses which are close to consuming regions is growing, and major Japanese and ROK household electrical goods manufacturers are moving their distribution warehouses for the Russian market from Finland to Moscow. Furthermore, as the import duties on household electrical products have been raised, there is the movement to construct factories in Russia and commence local production. Saint Petersburg Port and the Finnish ports are being used as the transportation route for freight headed for the Moscow distribution warehouses from Japan.

Second, because of the fact that restrictions by the Russian government on the road borders between Finland and Russia have been rumored, firms can be seen which are distancing themselves from Finland from a standpoint of crisis management. The use of Saint Petersburg Port as an alternative route is increasing. At a time of economic slowdown, there is also the backwind of the congestion at Saint Petersburg Port having been eased.

Third, with the Baltic states being actively for the attraction of transit freight, firms moving their Russia distribution hubs from Finland are becoming apparent. Meanwhile, the countering Finnish side has the confidence that it won't be beaten by the ports of the Baltic states in the area of service. Even among Japanese firms there is the view that expresses doubt about the smooth border passage from the Baltic states to Russia.

Fourth, there is movement on the utilization of the Trans-Siberian Railway in the transportation of automobiles. While Japanese automobile manufacturers have placed high confidence in the route for transporting finished cars to Russia and the CIS via Finland, on the other hand there is also the dissatisfaction of it taking too many days. In the case of going via Finland, it requires approximately 50 days from Japan to Moscow, and approximately 60 days to Central Asia. In autumn 2008 Mazda succeeded in the transportation of finished cars to Moscow by rail, via the port at Zarubino in Primorsky Krai. They arrived in 18 days, from the Japanese port to Moscow, and compared with going via Finland realized a reduction of approximately 30 days. Other Japanese automobile manufacturers are also interested in the same route.

2. The Current Situation of Finnish Ports

Container transportation in Finland is centered on three ports: the Port of Helsinki, the Port of Kotka and the Port of Hamina, and constitutes 76.6% of the total containers and 96.4% of the transit containers which all Finnish ports handle (2008).

Among the three ports the growth of the Port of Kotka, which has put effort into the attraction of transit containers bound for Russia, is pronounced. For the Port of Hamina also, which is closest to the Russian border, transit is the mainstay, but in comparison with the Port of Kotka, with the difference in frequency of feeder services, etc., it is leveling off. In contrast, the Port of Helsinki, which is far

from the Russian border, is rated as the import and export domestic freight port.

The results for the container handling of the Port of Helsinki in 2008 were 419,809 TEU, number two for Finland. Transit containers were low at 25,957 TEU (6%). As the proportion of the decline from the downturn is low in comparison with the Port of Kotka, in terms of the results for the container handling for January to September 2009 it has exceeded Kotka. The port, armed with the cutting-edge facilities of the new port—with its opening in November 2008—and its good service and access, is attempting to regain the top-ranking for Finnish container ports.

The Port of Kotka is a large-scale comprehensive port situated 125 km to the east of Helsinki. In terms of the volume of containers handled in 2008 it was number one for Finland with 627,769 TEU, of which transit constituted the most at 263,839 TEU (42%), and 70% of the transit containers for Finland as a whole. Limiting matters to imported loaded freight the share of transit amounts to 87%. The volume of containers handled for January to September 2009 decreased 46.4% compared to the same period for the previous year. The Port of Kotka is also a hub for the export to Russia of Japanese manufactured automobiles (new vehicles). The results for January to September 2009 fell 82.0% on the same period for the previous year.

The Port of Hamina is situated 40 km further to the east than the Port of Kotka and the furthest east at 35 km from the Russian border. In terms of the volume of containers handled in 2008 it was number three for Finland with 178,804 TEU, of which transit was 73,905 TEU (41%). Limiting matters to imported loaded containers the share of transit amounts to 77%. The volume of containers handled for January to September 2009 fell 43.6% on the same period for the previous year, and also the number of finished cars handled slumped by 43.4% on the same period for the previous year.

3. Consideration concerning Transit Transportation to Russia

1) The Future of Finland Transit

What use will be subsequently made of the functions of Finland transit, which has come to bear a key role as a Russian western gateway? Already Russia has created a policy of converting transit trade to the use of its own ports. The prevention of tax evasion and the business promotion of Russia's ports are seen as the objectives.

As a concrete measure, Russia announced a policy to restrict the entrance and exit of lorries crossing the road borders between Finland and Russia. If the road borders are restricted, it is thought there will be a choice as to: whether they will accept the border customs clearance for which troublesome formalities are necessary; whether they will switch lorry transportation over to the railways; whether they will land freight directly at Russia's ports, such as Saint Petersburg Port; or whether they will transport it overland using the ports of the Baltic states and Western Europe. Japanese and ROK firms have started moves with an eye to changing to alternative routes.

Meanwhile, for Finland, transit has created employment for approximately 4,000 people and port and distribution business, and considering the economic effect

they won't let it go.

Will the road border restrictions really be put into action? The two countries are quoted as being in the middle of negotiations on this issue, and appear to be readying countermeasures in preparation for the worst-case scenario.

Finnish experts, however, are convinced that transit is a must in the medium term. Presently, because import freight has decreased with there happening to be a downturn, Saint Petersburg Port too appears to be not so congested, but if the Russian economy moves toward recovery the volume of imports will increase, and the congestion will look to start again. In that case, there is the judgment that Russia will have to turn to the transit transportation route. Further, for the Russian ports, in addition to the deficiencies in the physical processing capacity, there is also no sign that the problem of troublesome and opaque customs procedures will be resolved, and it is thought that Finland's high-quality distribution service will be able to exercise its competitiveness. It carries weight from the viewpoint alone of being a country with a long association with Russia.

In addition, the currently under-construction port of Ust Luga requires some time until its completion, and it is regarded that they still have problems, including overland access to major cities and the securing of a local labor force.

In comparison with the ports of the Baltic states, Finland has the geographical advantage of being closer to Russia, and also in the areas of security and service it has absolute confidence. Furthermore, the political relations between the Baltic states and Russia cannot be called good, and there is also the view that there is the possibility of problems arising with border-crossing.

If one takes the long-term view, however, the possibility is high for the infrastructure of Russia's ports to be made replete, including the operational start-up of Ust Luga port, and the prediction can also be heard that at such a time transit will become history.

For the user country of Japan, in terms of the choice of transportation routes, it is a case of the more the better. Toward Russia they just appeal that they don't want them to close the Finland transit entrance.

2) The Potential for Transit at Russia's Eastern Gateways

Although there is transit transportation which has achieved development at Russia's western gateways, at Russia's eastern gateways too they are experimenting with similar transit transportation.

The first is the Manzhouli-Zabaykalsk railway border route. Since TransContainer constructed transshipment facilities in Zabaykalsk in autumn 2008, this railway route is being actively utilized for transportation originating in China and bound for Russia. Movement toward utilizing this transportation route for transit transportation from Japan bound for Russia can be seen.

The advantages of this route are the high frequency of maritime transportation between Japanese and Chinese ports, the inexpensive and excellent service at Chinese ports, and the customs clearance in Zabaykalsk which can be called smooth compared to the Far Eastern ports. Still at the stage of experimental transports with each company,

it is going to be some time for full-blown transportation. It has come about that the service that Finland had been undertaking in the western part of Russia is being carried out by China on this route.

Second is transit transportation via Rajin port in the DPRK. Although it is still fresh in the memory that in October 2008 Russia incorporated railway improvement and port upgrading and actively promoted it as the Khasan-Rajin project, subsequent developments cannot be heard about due to political obstacles, etc. In addition to Russian

Railways, in the project that the ROK logistics firms of Korail, etc., have been promoting, there is a proposal of connecting by broad-gauge rail the port of Rajin, Tumangang, Khasan and Ussuriysk, and aiming for a connection to the Trans-Siberian Railway via the DPRK. This proposal will be for the DPRK to undertake the transit service which Finland had undertaken. For the realization of the route change in the political environment surrounding the DPRK is awaited.

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