

## 1.1 BASIC SOCIOECONOMIC INDICATORS

By present time, **the stabilization stage of socioeconomic development of the Republic of Karelia has been completed.**

The potential of positive trends appeared during the after crisis period, socioeconomic stability and implementation of economic policy measures by the government of Karelia Republic allowed to keep in recent years a positive dynamics of the majority of the most important economic indicators. According to the Socioeconomic Development Concept 'Karelia Revival' for the period up to 2012, the main task for the Republic is to **turn to the innovation development trends.**

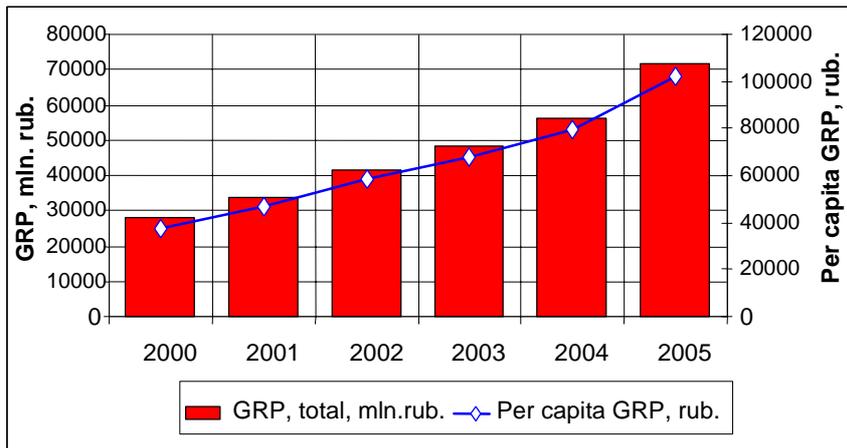
During 2002-2005, the Republic of Karelia demonstrated steady production growth in most industries, including the export growth. Every year demonstrated a continuing increase of such figures as retail turnover, the volume of chargeable services rendered to population, freight turnover of transport enterprises, the level of profits, real wages and pensions. Basic indicators of Karelia socioeconomic development for the year 2005 are summarized in Table 1.1.

**Table 1.1 Basic indicators of socioeconomic situation, the Republic of Karelia, 2005**

Indicators	2005	2005 to 2004, %
The overall turnover of organizations of all industries, mln. rubles <sup>1)</sup>	135 596.8	124.5
Mining operations	20 112.2	230
Manufacturing sector	32 609.1	118.8
Electric power, natural gas and water supply generation and distribution	8 792.5	113.9
Investment in fixed capital, mln. rubles	14 746.4	97.1
Volume of force-account works and services performed under 'Construction' line, mln. rubles	5 105.2	110.5
Exploiting of residential buildings, total floor area, sq. m.	88 461.0	93.2
Freight turnover, bln. ton-kilometers	25.7	100.1
Retail turnover, mln. rubles <sup>2)</sup>	28 616,4	108,4
Chargeable services rendered to population, mln. rubles <sup>3)</sup>	8 666.1	102.3
Foreign trade turnover (in actual prices), \$mln.:	1 244.8	119.9
Export (including the Republic of Belarus)	1 044.9	124.1
Import	199.9	102.0
The absolute number of registered unemployed (at the end of the year), thousand people	13.6	100.4
Real population income (i.e. adjusted for inflation rate)		103.5
Average monthly accrued wages per employee, all economic sectors, rubles		
Nominal	8747.0	125.3
Real		112.3
Consumer price index on goods and services		110.0 <sup>4)</sup>
Industrial producer price index		107.4 <sup>4)</sup>

1. Net of VAT, excise taxes and other payments.
2. The data on consumer goods turnover is given with adjustment for expert evaluation of the commodities informally imported and sold at general-merchandise, mixed and food markets.
3. Via all distribution channels.
4. December 2005 to December 2004.

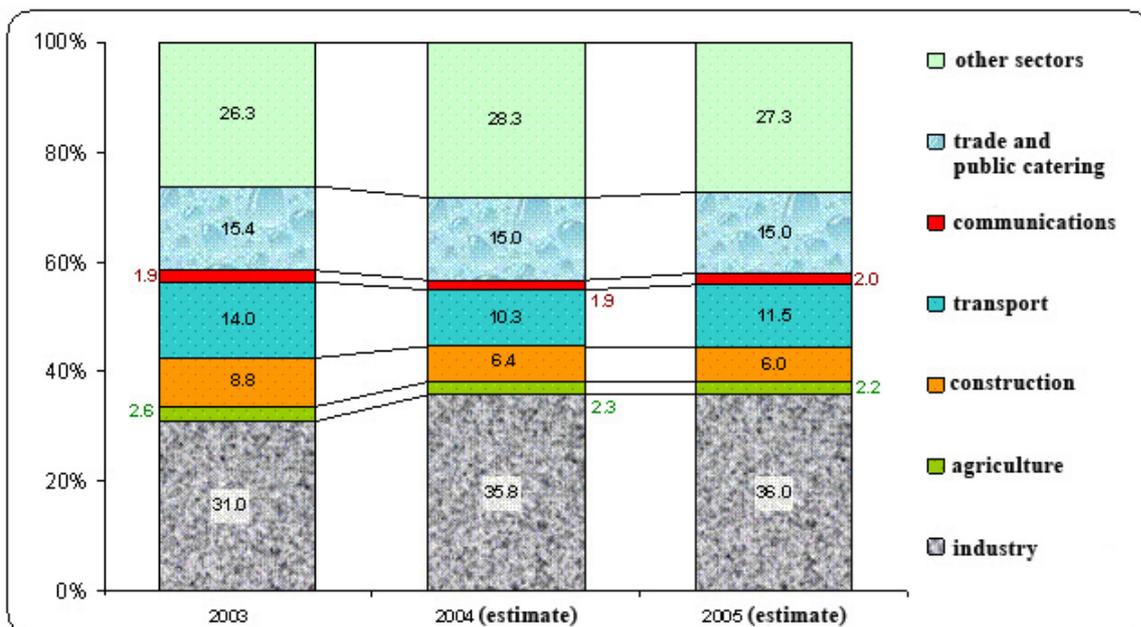
### 1.1.1 Gross Regional Product and its Structure



Starting from 1999, the Republic of Karelia gross regional product (GRP) has been growing in both absolute and per capita terms (see Fig. 1.1). Over the last four years, GRP has increased by 23.8%; growth rate in 2005 was 9% (in comparison to 2004). In terms of per capita GRP Karelia ranks the 26th place among the other RF subjects.

**Fig. 1.1 Gross regional product dynamics**

The base of the Republic's economy is **the industrial sector**, which, during the period 1999-2001, contributed more than 40% to the Karelian gross regional product. Slowing down of the growth-rate of industrial production physical volume, an increase in the relative share of intermediate industrial consumption, as well as the growth of other economic branches and sectors led to the decrease of the industrial weight in the value-added structure, developed on the Republic territory, up to 31% (see Fig. 1.2).

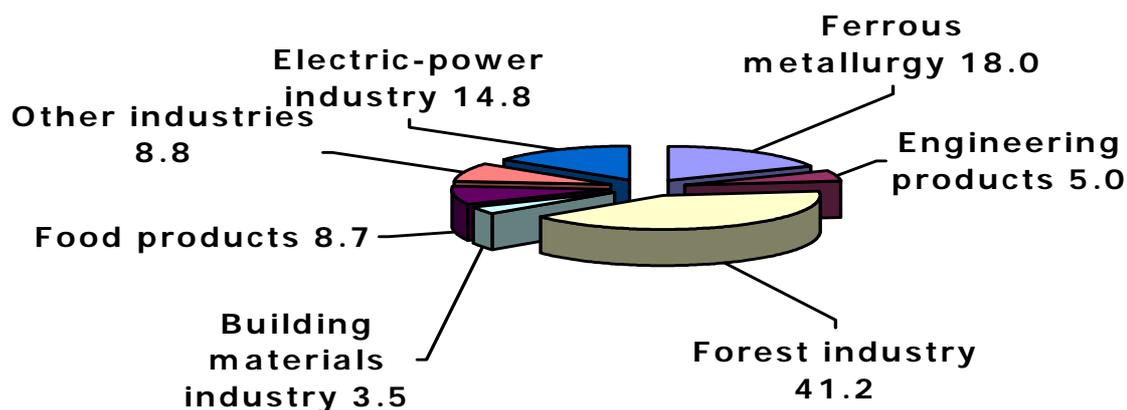


**Fig.1.2 The GRP Structure**

### 1.1.2 Industry

The industry plays a leading role in the Republic's economy. Due to the introduction of new production technologies and favorable business conditions for the main types of output, the physical volume of industrial production increased by 35.9% for 2002-2005, at the same time the industrial production growth ran up to 118 % in comparison to 2004 (throughout Russia – by 104%), which is the highest growth-rate over the last five years.

The industrial production is dominated by timber industry enterprises (see Fig. 1.3).



**Fig. 1.3 Industrial production by sector, %**

The timber industry products (these are logging, woodworking and pulp-and-paper industries) account 41.2% of the Republic's industrial output. A large proportion in the structure of industrial production is accounted for ferrous metallurgy (18%) and electric power industry (14.8%).

Timber industry enterprises employ more than a half of all industrial workers, and the production of the Republic's timber sector plays an important part at the Russian market. The Republic of Karelia produces 24% of all Russian paper, 35% of newsprint, 6% of industrial wood, 4% of carving wood, 3% of chipboards, and 59% of paper sacks.

In terms of paper sacks and newspaper production, Karelian enterprises are indisputable leaders nationally. About 35% of all iron-ore pellets are produced in Karelia.

### 1.1.3 Transport Infrastructure

The Republic of Karelia has a developed transportation network. Major highways, waterways and trunk-railways connect the region with the central and eastern parts of Russia. High performance of the Republic's economy depends in many aspects on the steady operation and further development of the transport sector and its infrastructure, optimization of transport communication network and reduction of transport costs.

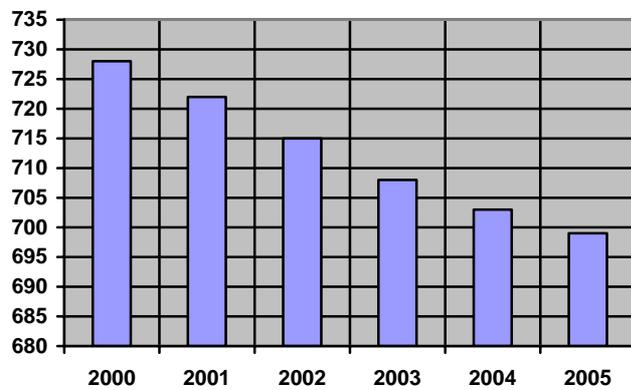
The total length of the Republic's highways is 13 331 km, specifically: the roads in general use (including the federal road "Kola") – 7 889 km, and departmental roads – 5 442 km. Hard surface roads are 60% of the total length of highways. The length of the Republic's railway lines and inland waterways is 2 226 km and 3 744 km, respectively.

In 2005, the annual freight turnover by all types of transport increased by 15% (in comparison to 2001) to stand at 25.7 bln. ton-km. An important role was played by an increase in investment into reconstruction, re-equipment and modernization of the transport sector and its infrastructure, amounting over 12 bln. rubles in 2002-2005.

The increase in freight turnover and in the demand for transportation services was developed along with positive trends of economic growth, increase of industrial production output and foreign trade turnover. The main factors for these improvements were the expansion of timber-harvesting and wood-processing operations, an increase in iron-ore pellets production, a higher growth-rate of mining and stone-extracting industry, and transport logistics development.

#### 1.1.4 Demographic Trends, Employment and Revenues

The demographic trends in the Republic of Karelia are generally positive: over the period 2002-2005, the birth rate increased, while the death rate declined. However the ratio of

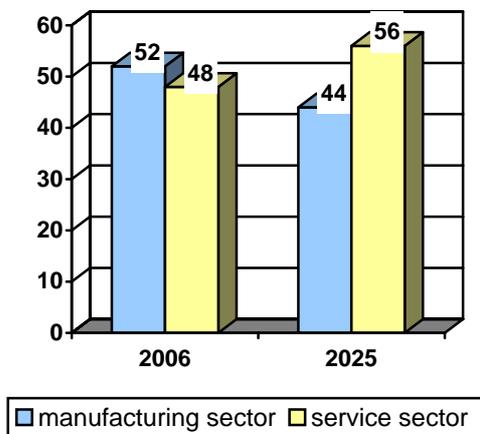


**Fig. 1.4 Population dynamics, the Republic of Karelia, thousand pers.**

demographic indicators generates negative population growth (see Fig. 1.4). The main factor contributing to the reduction of Karelia population is the natural loss of the population connected with high mortality factor. Over the year 2005 the total population of the Republic of Karelia declined by 0.8% to stand at 697.5 thousand people as of January 1, 2006.

According to the population forecast, starting from 2006 the region will enter a phase of net decline of working-age population. During 2006-2008, the population size will decrease

by 14.1 thousand people. The migratory factor will not dominate in labor force development in the Republic of Karelia (in 2002, net migration was 1909 people, in 2005 - 138 people). In the next three years the republic will experience insignificant positive migration balance.



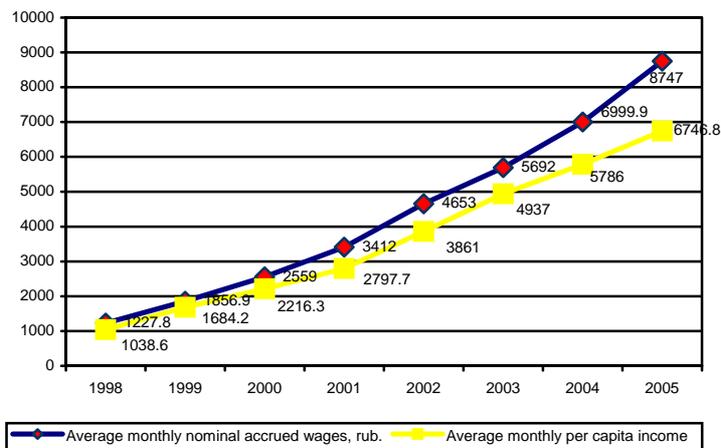
**Fig. 1.5 Proportion of employed in the economy by sectors, the Republic of Karelia, %**

Demographic processes and structural shifts in the economy have a strong influence on employment patterns in the Republic of Karelia.

It is expected that the dominant role in the employment sectoral structure will be played by services-providing industries rather than manufacturing ones (see Fig.1.5).

In 2005, the labor market situation in the Republic of Karelia was characterized as sustainable. The figures show a decline in unemployment rate, a higher activity of those searching for a job and shortening of the search period, stabilization dynamics of load

level to the labor market; positive trends in employment patterns (formed during 1999-2001) were developed. A high employment rate, along with other positive factors defined a positive dynamics of nominal wages and average per capita incomes (see Fig. 1.6).



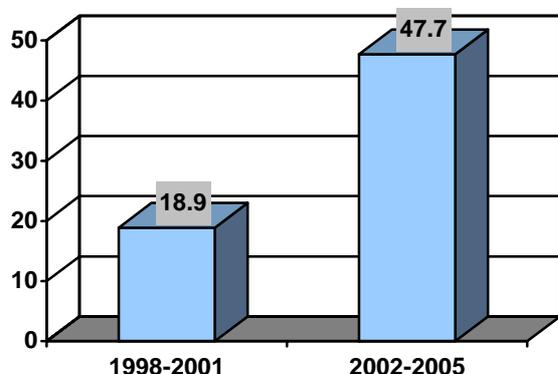
**Fig. 1.6 Nominal wages and average per capita incomes, rub.**

As of 1 January, 2006, the number of the unemployed registered in public employment office was 13.6 thousand (as of 1 January, 2005 - 13.5 thousand people). In 2005, the registered unemployment rate was 3.5%.

Industrial production growth and a higher level of investment in job development have contributed to increase in the demand for labor. The Republic's employees annually submitted to public employment bodies information about 36-38 thousand job vacancies (including occasional work). Skilled and highly-qualified workers were required for manufacturing sector, mining industry, construction and social services sector. Enterprises experienced especially acute lack of blue-collar, technical and engineering workers. The non-governmental sector formed a half of the region's labor force needs.

### 1.1.5 Investment

Implementation of the 'Investment Policy of the Government of the Republic of Karelia for 2003-2006' program bristled up investment activity in the republic that promoted growth of economy. Correlation of volumes of investments to the total regional product has made 21% that corresponds to the optimum level of the 'investment corridor'.



The most important result of active economic policy pursued by the government of the Republic of Karelia is the investment growth. Comparing two periods - 1998-2001 and 2002-2005 - one can see that the total volume of investment in the region's economy has grown more than in 2 times (see Fig. 1.7).

In 2002-2005 investments into fixed capital in the republic have made 47,7 billion rbl., that more than twice exceeds the volume of investments in 1998-2001 (18,9 billion rbl.).

In 2005 the volume of investments achieved 14,7 billion rub., that in a comparable estimation 1.2 times exceeds the standard of 2001. The share of investments into branches of the real sector of economy grows.

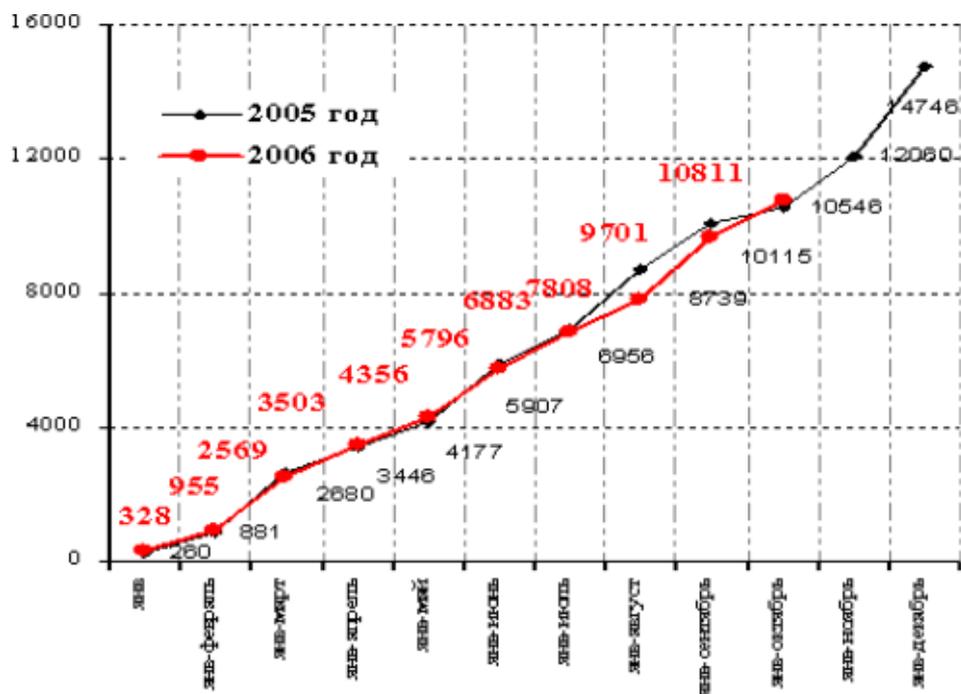
The republic has a number of distinctive features, which, together with well-directed efforts of the Republic government in terms of investment policy, enhance the investment attractiveness of Karelia:

- rich natural resources (timber, mineral resources, water) which provide opportunities for large-scale processing of raw materials;
- relatively low production and transport costs (in comparison with those in EU countries), giving investors an opportunity to take advantage of manufacturing co-operation and outsource production facilities to the republic for further output export to EU countries;
- border location, which allows to use opportunities in European fund raising programs in the sphere of ecology, technical assistance and staff training
- rich historic and cultural heritage in conjunction with unique Nordic nature, enables to fulfill a great recreational potential;
- advantageous geographic location - involving land communication lines connecting Finland with the northern European part of Russia, highways and trunk-railways linking the central Russia with Murmansk Oblast, unique water system providing an access to five European and Asian seas - ensures the prospects of exploiting transit opportunities;
- availability of research staff potential;
- traditional status of a region with moderate investment risks.

For 2006 in the Republic investment sphere following main tendencies could be observed:

- total volume of investment in fixed capital exceeds the last year level (in current prices);
- total volume of net financial assets increased, the proportion of short-range investments also slightly accrued;
- in general structure of investment in fixed capital on financing sources with regard to sources of financing the share of the external (involved) sources including budgetary funds increased;
- the highest part of investment in fixed capital is still in Kostomukshsky and Petrozavodsky districts;
- the part of investment on purchasing and setting up of machinery, equipment and transport increased in the total volume of investments in fixed capital;
- enterprises (including timber-harvesting and wood-processing) actively started using the leasing schemes of machinery and equipment purchasing but the indicators of their investment activities are not included into the statistical recording (*investment part of leasing is fully related to activities of one person – lessor, which is in most cases an organization located in St. Petersburg, Moscow and other territories*);
- the growth-rate of activities in construction sphere increased;
- the price growth on construction production is less than during the same period in 2005;
- the total volume of foreign investment into non-financial sectors of economy increased

In January-October 2006, the total volume of investment in fixed capital throughout the Republic of Karelia was 10811.3 mln. rub. or 99,2% to the same period in 2005 in comparable prices (fig. 1.8).



**Рис. 1.8. Dynamics of investment in fixed capital, mln. rubles (actual prices)**

The following factors had a constraining effect on investment activity in the reporting period:

- continuing growth of the manufacturing costs;
- insufficient demand for products;
- lack of owned funds; high interest on commercial credit;
- decrease of investment programs by large companies;
- slow progress of the system for transforming household savings and bank liabilities into investments.

Still, plans are to retain the last year's level of investment in fixed assets.

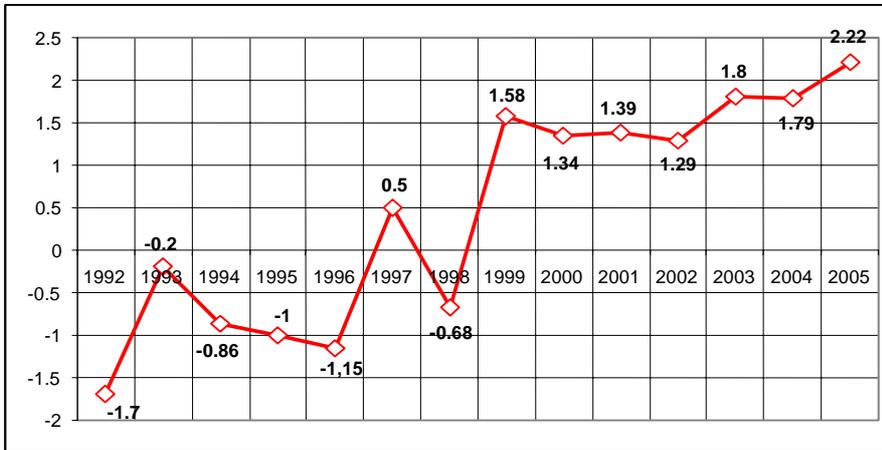
It should be observed the positive impact of following factors:

- decline of inflation rate;
- tax legislation improvement;
- reduction of the price for machinery and equipment imported from non-CIS countries - due to ruble strengthening;
- establishing a zero rate of import duty for processing equipment (including that for timber industry).

The government of Karelia addresses the need to create conditions for information transparency of the republic. The web-site 'Republic of Karelia for Investor' has been functioning since 2003. The purpose of the site is to provide a potential investor with relevant information (<http://www.kareliainvest.ru>). The Republic's legislation is also aimed at creating of favorable conditions for attracting investment resources.

### 1.1.6 Integrated Assessment of Socioeconomic Situation in the Republic

The total assessment of the level and dynamics of Karelia social and economic development is carried out by using the Integral Measure of Territorial Development (IMTD). IMTD is calculated on the base of indicators characterizing quality of life and economic development of the region (fig. 1.9).



**Fig. 1.9 The Integral Measure of Territorial Development (IMTD) dynamics**

Positive trends of the Integral Measure of Territorial Development observed in 2002-2005 indicate substantial progress in economic development, which increases the social potential of the region. Also the economy performance at the beginning of 2006 shows a significant decline of economic growth, which poses a question of the region's ability to sustain a high enough level of

economic development. A number of problems of both internal and external character have a constraining effect on the Republic socioeconomic development. Therefore, the republic needs not only to eliminate or reduce the negative impact of restrictive development factors, but also to use effectively the economic growth factors.

### 1.1.7 Foreign Economic Activities

Karelian enterprises successfully master practice of implementation of foreign trade operations under the open economic conditions. The competition to foreign companies, both on internal, and on the foreign market becomes a more significant factor for them, which defines decisions in the field of production and sales.

The region's foreign trade turnover is notable for dynamic growth. In 2005 it was \$1245 mln., including \$1045 mln. of export turnover. In the same year, the export of the goods produced by local companies by 62% exceeded the level of 2001. As positive processes in the structure of the Karelian export it is necessary to note escalating of volumes of export of new kinds of production of processing branches. The most dynamical growth was observed in volumes of export deliveries of ferrous metals and articles made of them - 6.2 times.

Import of goods in 2005 has made 141% to 2001, more than 40% of them fall on goods of investment purpose. Enterprises of the republic actively modernized their factory in recent, entered new production facilities that has caused 3.8 times growth of import of electric equipment.

Considering that more than 50% of production of Karelian enterprises is exported, one of the strategic purposes of economic development of the republic is creation of conditions for mutually advantageous development of foreign trade activities, diversification of export of Karelian enterprises both from the point of view of commodity and branch structure, and geography of export streams.

The principal foreign-economic partners of Karelia are: Finland, Germany and the Netherlands. The main factor of development of foreign economic activities is the development of existing and elaboration of new international transcontinental and regional transport corridors, such as: the Corridor 'North-South', systems 'Northern Sea Route' (NSR) and 'Federal Waterway Communications' (see Fig. 1.10).



**Fig. 1.10 The development of Karelia transport potential**